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# The Province of Alberta



IN THE MATTER OF "THE NATURAL GAS UTILITIES ACT"

-and-

IN THE MATTER OF an Enquiry into Scheme to be adopted for Gathering, Processing and Transmission of Natural Gas in Turner Valley

G. M. BLACKSTOCK, Esq., K.C., Chairman Dr. E. H. BOOMER, F.C.I.C., Commissioner

Session:

CALGARY, Alberta December 3rd, 1945

VOLUME 55

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9.30 A.M. Session, December 3, 1945.

MR. STEER: Mr. Chairman, I think perhaps I should say that the Appeals from the Board's Order were opened last week and not concluded and the Court adjourned the Hearing until the 12th of December, which is a date on which the Board normally would be sitting.

We will consider that before we adjourn THE CHAIRMAN: this week, Mr. Steer. Now Gentlemen, you all have a copy of the submission to be made by Professor Stewart. You have had it for some time and I hope you have all read and digested it, which I have not done. In view of the fact it is quite lengthy and that the cross-examination thereon may also be quite lengthy, Professor Stewart has prepared a summary of his submission and has copies of that summary Subject to your approval I suggest that Professor Stewart only read in evidence the summary, leaving the cross-examination of course to cover the whole field. If that suits counsel I think perhaps it is a pity to take up the time in reading the whole submission, which you no doubt have already digested. That will leave you free to your cross-examination and if that course is agreeable to you, gentlemen, that is what I propose to do.

MR. CHAMBERS: That is quite satisfactory to me, sir.

THE COURT: Of course if there are parts of that submission itself that you wish to put in, that will be put in. In any event I think I am going to suggest that although the main submission will be filed as an Exhibit, it might very well be included in the transcript.

MR. STEER: You think, Mr. Chairman, that it should

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be included in the transcript?

MR. CHAIRMAN: I am willing to do whatever you wish in that regard.

MR. STEER: What struck me about it is that the suggestion that Mr. Stewart should read his summary is an excellent one. But it does seem to me that we ought to have available the main document and that it ought to be included in the transcript.

MR. CHAMBERS: The copy I have got would indicate it has been mimeographed and if we had more copies available it might save some of the expense of including it in the record.

THE COURT: I have three more copies. Now you only got one, Mr. Chambers, and I think you should have another. You have two, Mr. Harvie?

MR. HARVIE: I have two, yes.

THE CHAIRMAN: You have two, Mr. Steer?

MR. STEER: Yes.

MR. HARVIE: We really should have more if it is not going to be included in the transcript but it seems a lot of waste expense if we can have more copies supplied.

THE CHAIRMAN: I think that can be arranged.

ANDREW STEWART, having been duly

sworn, testified as follows:

Q THE CHAIRMAN: Mr. Stewart, will you please let us have your qualifications, academic qualifications?

A I am a member of the Department of Political Economy of
the University of Alberta, with the position of Associate
Professor. I hold the degree of B.S.A. in Agriculture
and a Master of Arts degree in Economics from the University

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of Manitoba. I have been connected with the Appraisal Institute of Institute and a Life Member of the Appraisal Institute of Canada and have been on the examining Board of that organization for a number of years. I am also Canadian Vice-President of the American Society of Rural Appraisal. I think that is all, sir.

Now you have prepared a summary of your main submission but I would like to put in the main submission first. That will be Exhibit 131.

MAIN SUBMISSION OF PROFESSOR STEWART NOW MARKED EXHIBIT 131.

MR. HARVIE: That is the main submission, Mr. Chairman?

THE CHAIRMAN: The main submission is Exhibit 131.

Would you like the summary to be put in as an exhibit as well?

MR. CHAMBERS: Yes.

MR. HARVIE: It might be as well.

SUMMARY OF PROFESSOR STEWART'S SUBMISSION NOW MARKED EXHIBIT 132.

Q THE CHAIRMAN: All right, Professor Stewart, if you will now proceed to read the summary.

A

# ALTERNATIVE METHODS OF PUBLIC UTILITY VALUATION FOR PURPOSES OF RATE CONTROL

#### I. THE APPROACH TO THE PROBLEM

This submission is concerned with the general problems and principles involved in determining the rate base and rate of return for purposes of rate setting under public utility control.

II. THE GENERAL OBJECTIVES OF PUBLIC UTILITY REGULATION

The development of consistent principles and procedures

requires that the objectives of public utility regulation be

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stated in a manner capable of precise and consistent interpretation.

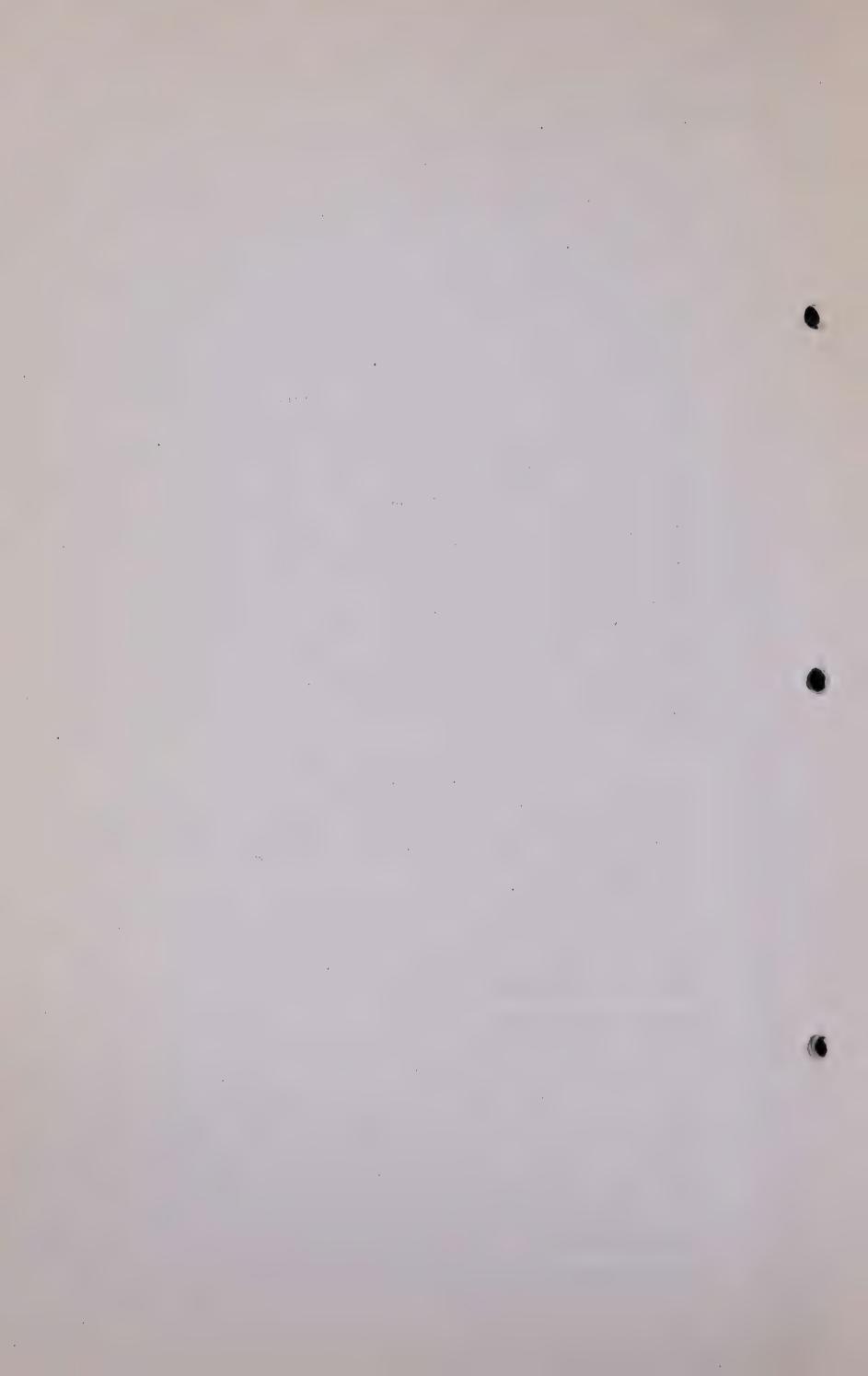
The paramount objective of public utility regulation is the protection of the public interest and the securing of desirable public objectives. It is possible, and desirable, to interpret the public interest more widely than that of the interests of the consumers immediately affected.

other objectives may be considered as merely means necessary to achieve the primary end of public advantage. Adequate inducements to the investment of capital funds and to initiative and efficiency of management are necessary to secure efficient public service under conditions of private investment and management. Regulatory procedures, clearly defined and capable of consistent application, are necessary to maintain public confidence and provide assurance to investors.

#### III. THE RATE BASE

where the initial step in determining the rate base is an appraisal of the property new, allowance must then be made for depreciation.

While it may be useful to distinguish between different sources or causes of depreciation, the significant offect which it is designed to measure is the reduction in "value". The "value" of properties may decline as a result of a fall in the demand for and prize of the products. When properties are "valued" at current prices, any depreciation due to this factor may be assumed to be accounted for. Properties may suffer a decline in serviceability due to physical wear and tear. The allowance for depreciation should be adequate to account for this. The value of properties may decline because of obsolescence; the extent of the decline in value being



represented by the difference between the value of the existing property new and the present value of an alternative new property. The depreciation allowance should account for obsolescence.

At the time of investment in a property it is sound procedure to provide for replacement over the expected life of the property, as determined both by wear and tear and by obsolescence. Apart from the advantage to the company, it is proper that current users should be charged with the depreciation incurred in providing them with the service. The accountant, recognizing this, thinks of depreciation as "amortized cost"; and at the time of appraisal, seeks to measure depreciation by the amount which should have been withdrawn from capital account and charged to income account or to reserve in accordance with accepted accounting principles.

Provision for replacement could be made on the basis of any one of a number of formulae based on useful-life expectancy. Of these formulae the straight-line method has perhaps most to commend it; although this method implies that depreciation is a simple function of time. If the accountant accepts the straight-line method as appropriate in the particular case, then the depreciation (amortized cost) at the time of appraisal would be determined by the expected life of the property new and the years it has been in use.

Depreciation so determined may diverge appreciably from the provision actually made for depreciation by the company and from the realized depreciation; and the provision for depreciation by the company may bear no significant relation to realized depreciation.

Where the accounting procedures of the company have not



been subject to regulation, that is, in the case of a company which is being brought under regulation for the first time, it cannot be assumed that the provision made for depreciation accurately, or even closely, reflects the realized depreciation. Under these conditions the records of the company cannot be used to measure the depreciation to be allowed in determining the rate base.

Even if the company has followed accepted accounting principles, applying an appropriate formula, the provision for depreciation (and the amortized cost) may be greater or less than the realized depreciation. The rate of depreciation derived from depreciation formulae are necessarily related to average past experience. In particular cases, therefore, the realized depreciation, due to both structural and functional causes, may exceed or fall short of the anticipated depreciation based on useful-life expectancy data.

For this reason, in the case of companies coming under regulation for the first time, the method of determining depreciation by inspection may be preferred. The estimate of depreciation obtained by inspection should account for depreciation due to both structural and functional causes; and it may be noted that there is a tendancy for estimates of depreciation based on observation to under-estimate the realized depreciation resulting from wear and tear.

Once a utility is brought under regulation, and if it is required to follow prescribed procedures in making provision for depreciation, the risk inherent in investment in property and associated with the uncertainty of depreciation, may perhaps properly be borne by the consumers; and the risk to investors is then correspondingly reduced.

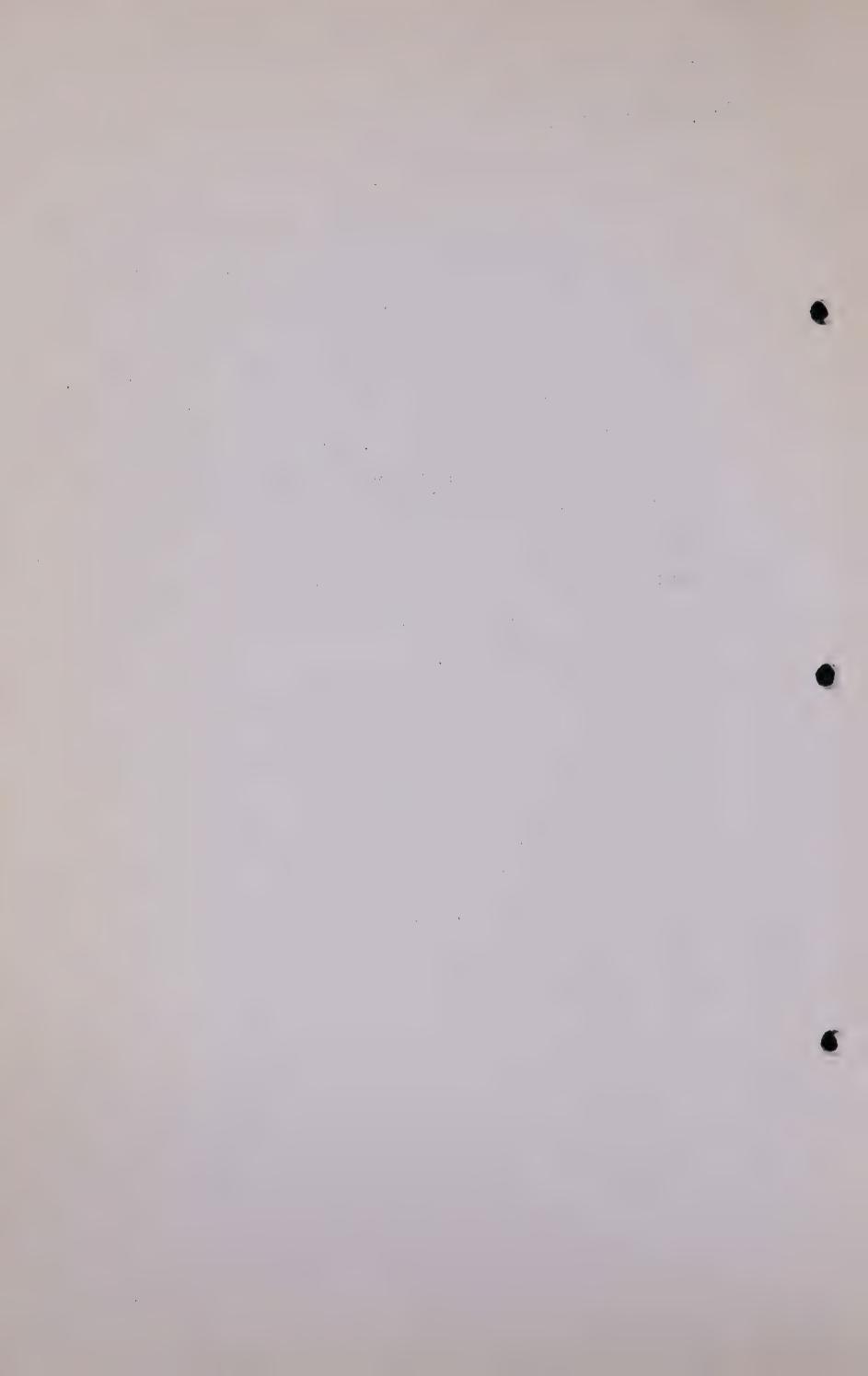


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A further consideration occurs in the case of a wasting asset. Where a wasting asset is involved, it is reasonable to assume that the original investment was made with the expectation that the full amount of the investment could be recovered before the exhaustion of the material occurred. The amount of reserves and rate of use determine the maximum useful life of the properties. Under these circumstances it would be sound practice to transfer the investment on plant to income account or to reserve at the rate at which the material is used up. Consequently the appropriate method of arriving at depreciation, at the time of appraisal, would appear to be to calculate depreciation as if the investment had so been transferred.

Even if knowledge with regard to the amount of reserves has changed, the reasonable principle for a regulating body to adopt would appear to be that the estimate of reserves involves a risk which the investors were prepared to carry; and that calculation of depreciation due to depletion must proceed on the basis of current knowledge. If current estimates of reserves still involve uncertainty, this is a factor which may properly be taken into account in determining the allowed rate of return.



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## IV. METHODS OF DETERMINING THE RATE BASE

## (1) "Fair Value"

Two criteria of "fairness" would seem useful in the regulatory process. Action by an administrative board might be considered "fair" (a) if such action were not inconsistent with the reasonable expectations of the interested parties; and if (b) the results were no less favourable than those offered by alternative opportunities. It is suggested that the concept of "fairness" might be supposed to embrace both "reasonable expectations" and "alternative opportunities".

There is no single measure of "value" which has equal significance and applicability for all purposes. The attempt to compromise between different measures of value leaves the problem without any systematic basis of solution. Exchange, sales, or earning value is inapplicable to the determination of a rate base. It is now generally conceded that the term "rate base" should be used in preference to "value".

## (2) "Cost"

Cost is now recognized as relevant to the deter-

If reasonable results are to be obtained in particular cases, certain principles must be followed in determining the relevancy of particular items and the allowance for each item which is to be included in the estimate of total cost. First, the allowance should be based upon cost and not on evidence of capacity to derive earnings. Second, the allowance should not include any element of "cost" which is attributable to the monopolistic position of the utility.

Third, factual evidence in particular cases is to be preferred to the application of general formulae which may have little relation to the particular situation. Fourth, it is essential to avoid duplication and overlapping such as would inflate the aggregate cost by allowance for the same factor in several places.

# (a) "Reproduction Cost"

Under the customary procedure, which involves appraisal of the properties at current prices, the relevant items of reproduction cost are the replacement cost of existing structures, overhead costs incurred during construction, working capital, and capital expenditures actually incurred in the purchase of land and the securing of other property rights.

If the identical plant principle is adopted in the appraisal, allowance for obsolescence must be made under depreciation. Under the principle of used and useful, obsolete standby and reserve plant should be included at replacement cost new less an allowance for obsolescence based on a comparison of operating costs; and in the case of property held in anticipation of future use it should be assumed, in the absence of clear evidence to the contrary, that the utility has exercised good judgment. Overhead costs, including legal expenses, engineering and supervision expenses, interest and taxes during construction, and possibly provision for omissions and contingencies are legitimate elements of cost. allowance for working capital should, preferably, be determined from the records of the utility; and it should be assumed that the established policy of the utility has been wisely chosen.

<sup>.</sup> 

The inclusion of any allowance for intangibles (goodwill, going-concern value, etc.) cannot be supported unless in the particular cases the acquisition of intangible property rights has involved expenditure on the part of the utility. Allowance should be made for such expenditures when they have been incurred, and have not been charged to operating expenses and thus recovered in rates. The same principle i.e. actual cost, should also be applied in the case of land.

It should be noted that the problems of goodwill. going-concern value, and intangibles are closely related; and it is possible to conceive of these "values" as having arisen out of the unusual efficiency of the utility. community has a right to expect that its utilities are efficiently operated, and under public utility control it is the intention that an efficiently operated utility should be able to earn the allowed return through the rates established. But there is a danger if the rate base includes nothing more than the replacement cost of the physical properties plus overheads and working capital that, in particular cases, utilities coming under regulation may lose the fruits of the special efficiency with which the utility has been operated. Consideration of this point would throw on the regulating body the problem of judging the efficiency with which the utility has operated in the past.

When the reproduction cost method is applied there is no relation between past accounting and the present determination of depreciation; and the appropriate procedure appears to be to determine depreciation by inspection.

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# (b) "Original Cost"

Original cost in the sense of unimpaired investment can be determined only if accounting records have been kept so that expenditures properly charged to capital account can be ascertained. When adequate records are not available the actual (or estimated) cost of the properties now employed in the public service may be determined by an appraisal of the existing facilities using prices as at the date of construction or installation. This appraisal is subject to the addition of overheads and working capital, and to the deduction of depreciation.

The principle of prudent investment should be applied to ensure that money has been reasonably and properly expended, to eliminate excessive facilities, and to ensure proper charges for obsolescence. Every investment should be assumed to have been made with the exercise of wise judgment, unless clear evidence to the contrary can be produced.

In relation to overheads, intangibles, going concern value and land, the principle is clear; only costs actually incurred and properly chargeable to capital account may be allowed.

If, at an initial determination of the rate base it appears that depreciation has not been adequately or properly accounted, depreciation should be determined by inspection. Once a utility has been brought under regulation, the initial rate base has been established, and actual cost has been approved as the procedure for measuring the rate base on future occasions, the subsequent proceedings can be greatly simplified by the adoption of an approved system of accounts.

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#### V. THE RATE OF RETURN

The general principle adopted in the determination of the allowed rate of return is that of the selection of a rate which would be required to attract the necessary funds if the properties were to be reconstructed under prevailing conditions. This principle is consistent with the reproduction cost basis of valuation; and assumes the relevance of alternative opportunities. The inducement necessary to attract funds is the prospect of a rate of return equal to the rate which can be secured in other, comparable, investments.

The recognized constituent elements in the rate of return are pure interest and a differential return for the assumption of risk. Pure interest, represented by the return on "safe" securities does not vary between different long-term investments, but fluctuates over time. The risk differential varies between different investments, and "comparable" investments are therefore those in which the element of risk is the same.

The hazards affecting utilities are various. Because of differences in risks the appropriate rate must be determined in the light of the particular circumstances; and it is difficult to discover the "comparable" investments which would provide a guide to the necessary rate. The principle of alternative opportunities, while generally valid can, in practice, provide only a rough approximation to the appropriate rate in particular cases.

Because other aspects of regulation, including the method of determining the rate base, affect the risk to investors, the appropriate rate of return cannot be determined

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separately and without consideration to the procedure adopted in other areas of regulation.

Customarily the rate of return allowed is an overall rate applied to the entire rate base regardless of the source of capital and type of securities issued. It is questionable whether this procedure can be logically defended. If the proportion of bonds and preferred stock is relatively high, and the rate of return is greater than the fixed contractual return on these securities, the actual return to common stock holders may prove to be very great. Conversely, if the ratio of fixed return securities is low, the margin of return remaining for common stock holders may be unduly low. These effects of the financial structure are intensified when the rate base valuation diverges significantly from the actual investment.

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# VI. COMPARISON OF THE EFFECTS OF "REPRODUCTION COST" AND "ORIGINAL COST"

"Original Cost" provides for a relatively fixed rate base, whereas the rate base determined by the method of "reproduction cost" varies with recurrent changes in the prices of the materials and labour going into the construction of utility properties. It is the consequences of this difference which are significant in judging the relative merits of the two methods. The criterion of merit is the extent to which each method can meet the objectives of regulation.

## (1) Administrative Aspects

It is generally conceded that, on administrative grounds, the determination of the rate base by the method of original cost is to be preferred. Assuming that adequate records are available the determination of the initial rate base proceeds from a set of recorded facts. It is true that the records must be closely scrutinized and that contentious points will arise.

Once the initial rate base is determined, and an approved system of accounting adopted, the administrative advantage lies clearly with the fixed rate base. The procedure of determining actual cost is simple, systematic, and capable of reducing the time and expense of proceedings to a minimum. In contrast, the continuous application of reproduction cost by customary procedures is involved, expensive and uncertain. The basic concept on which the method rests is obscure; there is no precise procedure for appraisals unless some rule-of-thumb judgment is adopted as an administrative expedient; in theory, reappraisal should be undertaken whenever a noticeable change in prices occurs.

In view of the practical difficulties it has been suggested that reproduction cost might be estimated by the use of index numbers. This method would be systematic and could be readily administered.

- (2) Effects on the Utility
- (a) Inducement to Capital

The problem of "fairness" to investors arises only in connection with present holders of securities; and the principle of reasonable expectations appears to be involved.

In the past more consideration has been given to reproduction cost than to original cost. On grounds of equity therefore there would appear to be a strong case for determining the initial rate base by reproduction cost. However, the decision might be influenced by the time at which and the direction from which the movement to bring the business under regulation is initiated, and by the subsequent basis for determining the rate base.

ors, where regulation is imposed by legislation, the utility might be permitted to select the method of rate base determination which appeared most favourable to it. This would tend to make original cost the minimum and reproduction cost the maximum.

The application of reproduction cost to the determination of the initial rate base, followed by the adoption of actual cost would, if the initial determination were made during a period of high prices, fix this high valuation in the rate base in perpetuity. This is beyond the reasonable expectation of investors under reproduction cost; and it might be concluded that present reproduction cost during a period of

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high prices would constitute too large a concession to existing holders of securities, and that the criterion of "fairness"
might be met by the application of prices at some lower, and.
more normal level.

In the case of new investments and new investors the problem of "fairness" does not arise. What is required is regulatory policies which will make investment in public utility enterprises sufficiently attractive that utilities will be able to secure the capital they need promptly and without having to offer a premium for it.

The effect of the application of reproduction cost, if continuously applied, would be to affect utilities with the same irregularities which characterize the unregulated segment of the economy. Under original cost the irregularities would be reduced. Opinions differ on the effects of these alternative conditions on the availability of investment, as distinct from speculative funds.

From the long run investment point of view the original cost base provides the prospect of a more stable return in dollars; the reproduction cost rate base provides the prospect of relatively unstable return in dollars. It is possible, but not certain, that the returns in terms of purchasing power are more stable under reproduction cost. Prices of materials and labour do not move in strict conformity to changes in the cost of living; and purchasing power evaporates when dividends are passed.

Under both original cost and reproduction cost, fluctuations in returns depend on the policy with regard to reserves.

Perhaps all that can be said is that the two types

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of rate base offer different conditions affecting long term investment, and will therefore tend to attract funds from different types of investor. There is no conclusive evidence that the choice between the fixed and variable rate base will, in the long run, make any substantial difference to the availability of capital for expansion and development.

(b) Incentive to Efficiency

By itself neither of the principal bases of rate base determination offers any special reward for administrative efficiency; and it is difficult to reach any conclusion on which would have the more dampening effect on initiative.

- (3) The Public Interest
- (a) Allocation of Capital between Alternative Uses

It is sometimes argued that during rising prices, an increase in the rate base (and therefore in returns) is necessary to enable utilities to compete for new investment funds; and that during periods of falling prices, a decrease in the rate base (and therefore in returns) is necessary to prevent an excessive flow of funds into utility expansion.

In so far as the problem is a real one it is largely a matter of timing. Further the problem is one of securing new funds for capital development. If, during a period of rising prices, it appears desirable to expand, it should not be necessary to raise the rate of return on capital previously invested, in order to attract new funds.

(b) Promoting general stability

The variable rate base, in so far as it induces investment during periods of rising or high prices, and discourages investment in periods of falling or low prices, does

Andrew Stewart, Dir. Examination. Cross-Exam. by Mr. Chambers.

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nothing to promote general stability, and doubtless aggravates the tendency to instability. The fixed rate base, in so far as it results in a different timing of capital development, discouraging investment in periods of rising prices and inducing investment in periods of falling prices, would operate as a stabilizing factor.

In either case the effects depend on the policy with respect to reserves and capital expansion.

(c) The Interest of Consumers or Users

The main defect of the fixed rate base is that, in periods of high prices with high employment and earnings, rates determined on this basis would be relatively low; and in periods of low prices with low employment and earnings rates would be relatively high.

THE CHAIRMAN: Is there anything you wish to add to your summary before cross-examination, Mr. Stewart?

- A I do not think so, Mr. Chairman. It will be noted though I think that I do not offer any recommendations with regard to the rate base which might be appropriate to particular cases. do not wish to avoid that issue if it might be thought I had something useful to contribute there.
- I shall not ask you to, Mr. Stewart, but it is within the bounds of possibility that someone may. We will await the event. Now have you any arrangement as to which of you will cross-examine first. If not, whoever is ready will go ahead.

  MR. McDONALD:

  I think we have nominated Mr. Chambers to go ahead.

# CROSS-EXAMINED BY MR. CHAMBERS:

Q Professor Stewart, would you in general agree with me that

Andrew Stewart, Cross-Exam. by Mr. Chambers.

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the Anglo-Saxon countries have made the most progress in obtaining the highest general standard of living for their people ?

- A Yes.
- And would you also agree that by that term, highest standard of living, we mean that the people by their efforts, manual, clerical or otherwise have on the average the use and benefit of most of the commodities, goods and services than those of other countries?
- A Yes I would interpret that the standard of living is in terms of goods and services.

MR. HARVIE: I wonder, Mr. Stewart, if you would speak a little louder?

- A Yes I will. Thank you.
- Q MR. CHAMBERS: And when we speak of the Anglo-Saxon countries of course we mean Canada, United States and Australia and Great Britian. Would you add some more to those?
- A That would be sufficient.

  THE CHAIRIAN: You omitted Ireland.
- A I still think that would be sufficient.
- MR. CHAMBERS: Now Profressor Stewart, I suggest to you and I am asking you whether or not you agree that at least one of the main and basic reasons for that result is that individual initiative has been encouraged in those countries to a greater degree than in many others?
- A I do.
- Q Would you agree with that proposition ?
- A Yes.
- Q And I further suggest to you that that initiative has been encouraged, first of all by persons of ingenuity and skill

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being encouraged to develop and enjoy the fruits of their efforts. Would you agree with that proposition?

- A Yes.
- Q And it has also been encouraged by persons or groups of persons with funds, being encouraged to put them to use in enterprises and developments. That would be a sound proposition?
- A Yes.
- And I also suggest that has been encouraged by those persons or groups of persons being able or at least being encouraged to bank upon their being able to reap the benefits of their skill, their foresight, or their luck in the use to which they put their money and also the fruits of their daring. Would you agree with that proposition?
- I think it involves both that; that is the opportunity to reap their reward and also the responsibility to bear the losses.
- Q Yes, but that people have been encouraged to take risks because while they have to bear the losses they are also encouraged in that they are going to get the benefit of their reward?
- A Yes.

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- And also I suggest to you in those countries that we have just mentioned that they were so encouraged by the knowledge that, in general, the rules or the laws surrounding the adventures could be relied on as being basically stable. Would you suggest that as a factor?
- A I think that is a very important factor.
- Q And you would agree with that proposition?
- A Yes.
- And another reason, of course, I take it, is that they were, and that is more or less involved in what I have already put, that they have been encouraged to a certain extent by the general stability of their governments?
- A Yes.
- Q That would enter into it?
- A Y<sub>G</sub>S.
- Then would you agree with this proposition that in those countries that we have talked about, the peoples or these groups of peoples, were encouraged in their initiative by the prevailing general principles of government and law that their property or the fruits of their skill or their daring would not be taken away from them or deprived to them except with due compensation being made. Would that, in your view, be one of the many elements entering into this matter of progress of these Anglo-Saxon countries?
- A I would go as far as that, yes.
- And just to get down to specific and concrete instances of what we are talking about, so far as the British Isles are concerned, we have perhaps in the early days certain memorable matters of governmental discipline, or what occurred to me, you have got the Magna Charta first, and we have the Petition of Right and the Declaration or the Bill of Rights. Now, my understanding is

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that those are the landmarks, as it were, that assured to the citizens of that country their personal liberty and their personal rights to the fruits of their labours. Would you agree with that?

- A Yes.
- Q Then I suppose you have read or are familiar with the Constitution of the United States?
- A I would not like to pose as an expert, Mr. Chambers.
- Have you run into this or read about it, Professor Stewart, there is an article in the American Constitution, that is so far as the Federal Government is concerned, that reads something like this, as a matter of fact I am giving it to you word for word.

  Article 5, "No person shall be deprived of life, liberty or property without due process of law; nor shall private property be taken for public use without just compensation." Were you aware that that was in the American Constitution?
- A I have heard the wording of it before, yes.
- And I would ask you to assume with me that there are somewhat similar provisions in each of the States of the American Union. But, in any event, assuming those items are in the Constitution of the United States and the various States, they would, I suggest, amount to nothing more or less than putting into concrete wording the matters that we have been discussing as one of the main incentives, or evidence of one of the main incentives, that have been held out for peoples in the British countries and the United States. Would you agree with that proposition?
- A I would, yes.
- Now, I am going to ask you to assume with me for a moment that there is not in our Constitution or in the Constitution of Great Britain, any specific provision similar to this Article 5 in the American Constitution. And, by the way, I suppose you have

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Andrew Stowart, Cr.Exam.by Mr. Chambers. - 4331 -

heard and you know, no doubt, that one of the basic conditions, rather that one of the basic differences between Great Britain and the United States is that Great Britain has no written Constitution. Are you aware of that?

- A I am aware of that, yes.
- And in this country while we have a British North America Act we have not a written Constitution in the sense that the United States has because in this country and in Great Britain the Constitution can be changed by any Parliament, though ours has to be changed at the moment technically in London.

THE CHAIRMAN:

Of course, Mr. Chambers, even if

Professor Stewart agrees with those propositions that you are

putting to him, he can hardly qualify as an expert on Constitutional

law.

MR. CHAMBERS: No.

THE CHAIRMAN: So that I might take the liberty of disagreeing with his agreement with you.

MR. CHAMBERS:

But I am asking him to assume certain things. If my assumptions are wrong, then, of course, any answer that he gives me follows.

THE WITNESS: On these matters is it all right for me to be rather ready to agree so that we can get on?

THE CHAIRMAN: No, you can please yourself.

MR. CHAMBERS: I would certainly make this clear,

Professor Stewart, if I ask you to assume something and the Board finds that that assumption is not sound, then your answer will not be binding. Your answer will be only binding assuming those assumptions are so.

THE CHAIRMAN: For instance, Mr. Chambers, I remember the Star Chamber between the Magna Charta and the Bill

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of Rights.

MR. CHAMBERS:

I am not purporting to give all

of the landmarks. Those are some of them.

THE CHAIRMAN: The Star Chamber was the law at the time or the procedure laid down at the time, the principles of law they used.

MR. CHAMBERS: I do submit that the Star Chamber

was washed out by the subsequent passing of the Bill of Rights.

MR. STEER: There is no difference between

the Star Chambers and the Court of Chancery.

THE CHAIRMAN: There might be no difference between

the Star Chamber and the Board of Public Utilities.

Q MR. CHAM BERS: Now then, Professor Stewart, where

was I at?

THE CHAIRMAN: You were at the Canadian Constitution

Mr. Chambers.

MR. GHARDERS: Well, I am asking Professor Stewart to assume that our Constitution has not written into it in so many words provisions similar to the American Constitution, and I am going to give you a quotation from one of the decisions of the Privy Council, not with the idea of your agreeing with me that that is the law, but I am going to later ask you to assume if that were so, if in your opinion it has certain consequences or a certain significance, and I am going to read a short extract from the judgment given by Lord Watson in the case of Western Counties Railway vs. The Windsor and Annapolis Railway, reported in 7 Appeal Cases, 178, at page 188, and also in 51 Law Journal, Privy Council, page 43, and in order to appreciate what I am driving at, I think I should just narrate briefly the background in which these words are placed. Our British North America

Act, the Constitution of this country, that is with regard to

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the powers of the various Provinces and the Dominion vested all railways belonging to the Province of Nova Scotia in the Dominion of Canada. That was the first. Now, prior to the passing of the British North America Act in 1867, the Windsor Rai lway Company entered into an agreement with the railway authorities in Nova Scotia, there was a Commission, to work a railway in the Province that was owned by the Province. Now, after the passing of the British North America Act in 1867 that agreement between the operating company and the Province was, in 1871, I think it was, adopted by the Dominion Government which had taken over the railways, and it was adopted by the Dominion Government for a term of 21 years, and the railway continued to be worked by this Windsor Company which was the operator. Now, shortly after 1871 and before 1874 the Windsor Company made default in the working agreement, but it, in fact, continued to work the railway. Now, in consequence of that default a Dominion Act of Parliament was passed in 1874 authorizing the transfer of the railroad, the railroad itself, to another company, the Western Counties Railway Company. And one of the conditions was that this company would extend the railway and build it, but it was transferred to them from the Dominion and that was in 1874. On August 1st, 1877, the Dominion Government just moved in and took possession of the railroad from this Windwor Company that had been operating it, and transferred it over to the Western Counties Company. Now, the Windsor Company, that is the railroad company, sued the Western Company to which the railroad itself had been transferred by the Dominion, and it sued for a declaration that the operating agreement of 1871 between the Dominion Government and the Windsor Company was in no way cancelled, and that the Statute of 1874 transferring the railway from the Dominion to the Western Counties

Company was in no way affected by the Statute transferring the railway. In other words, they claimed that the transfer of that railroad by the Dominion by virtue of this Statute, was subject to the operating agreement. In other words, the Windsor Company claimed it still had the right to operate it even though the other company owned it. Now, that is the background of this statement of Lord Watson. He says, that is, he is interpreting the Statute, he says:

"The canon of construction applicable to such statute is that it must not be deemed to take away or extinguish the right of the respondent company unless it appears by express words or by plain implication that it was the intention of the legislature so to do,"

and he goes on,

"The connunciation of the principle is, no doubt, much easier than its application. Thus far, however, the law appears to be plain, that in order to take away the right it is not sufficient to show that the thing sanctioned by the Act if done will of sheer physical necessity put an end to the right. It must also be shown that the Legislature have authorized the thing to be done at all events and irrespective of its possible interference with existing rights."

A.Stewart, Cross-Ex. by Mr. Chambers.

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wants. Would you more or less agree with that statement?

- A Yes.
- The first book, as I understand it, in economics, any recognized book, was Smith's "Wealth of Nations". Was that the starting point?
- A He is said to be the father of the science.
- Q That was published in 1776?
- A Yes.
- That was written or published just about the time of the beginning of the industrial revolution in Great Britain, was it not?
- A Yes.
- That was the starting treatise on this subject was it not?
- A I do not wish to quibble over it. I think I can go as far as that.

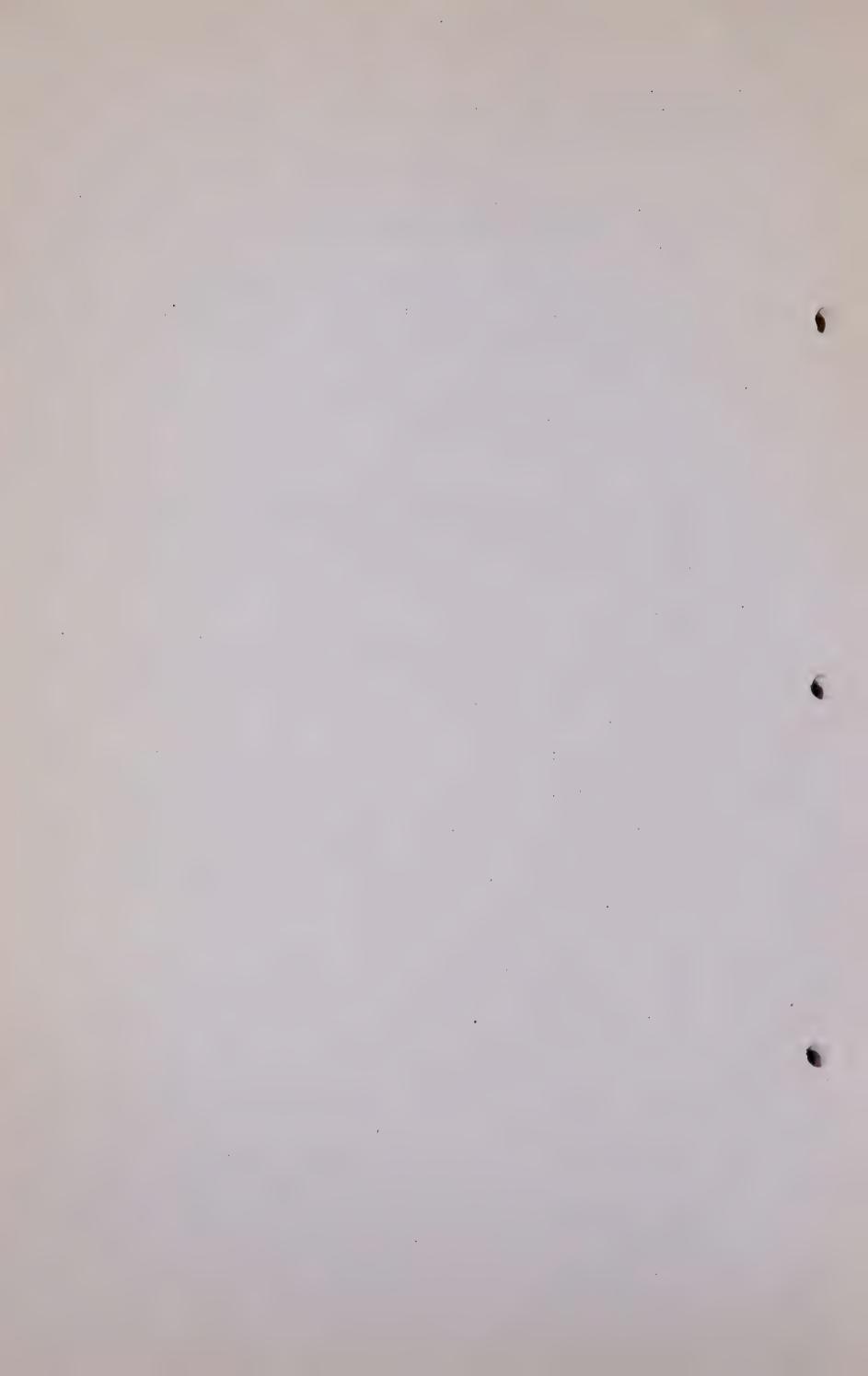
THE CHAIRMAN: It is very dreadful too, is it not?

- o MR. CHAMBERS: One of the things that Smith advocated in his book, as I understand it, and I quote this short phrase, was the "simple and obvious system of natural liberty." Do you remember that?
- A Yes, the term "natural liberty" is associated with Smith.
- And I mean Smith's approach to the subject and his theory
  was, as I understand it, that when each individual pursues
  his own self-interests that the best economic interests for
  society would be secured. That was more or less his
  philosophy?
- A More or less Adam Smith's philosophy, yes.

THE CHAIRMAN: Are you going on now to Jeremy

Bentham?

MR. CHAMBERS: I might.



A. Stewart, Cross-Ex. by Mr. Chambers.

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Now reverting back to what we have

been talking about, I put it to you as an economist that Article 5 of the American Constitution which I read to you and the interpretation of the legislative law in this country in line with what Lord Watson has said, that those things are instances of why people in the United States and in this country and Great Britain have been encouraged to take chances in the economic field. Assuming that is the law in this country and assuming that the Constitution in the United States contains the provision I read to you, would you agree with me that that fact is sound economics? Mr. Chambers, I'do not know whether I can go as far as that A on the specific cases which you have quoted but as an economist I would agree that stability in the legal framework is an essential factor to the assurance of investment and therefore is a factor in inducing and initiating investment and if that assurance is for any reason reduced or jeopardized, I would expect serious consequences to follow in the field of investment.

Now coming to the subject of economics and this may be, and
I am not suggesting it is altogether accurate, but a horseback definition of economics. "Economics is the science of
production and distribution and consumption of wealth."

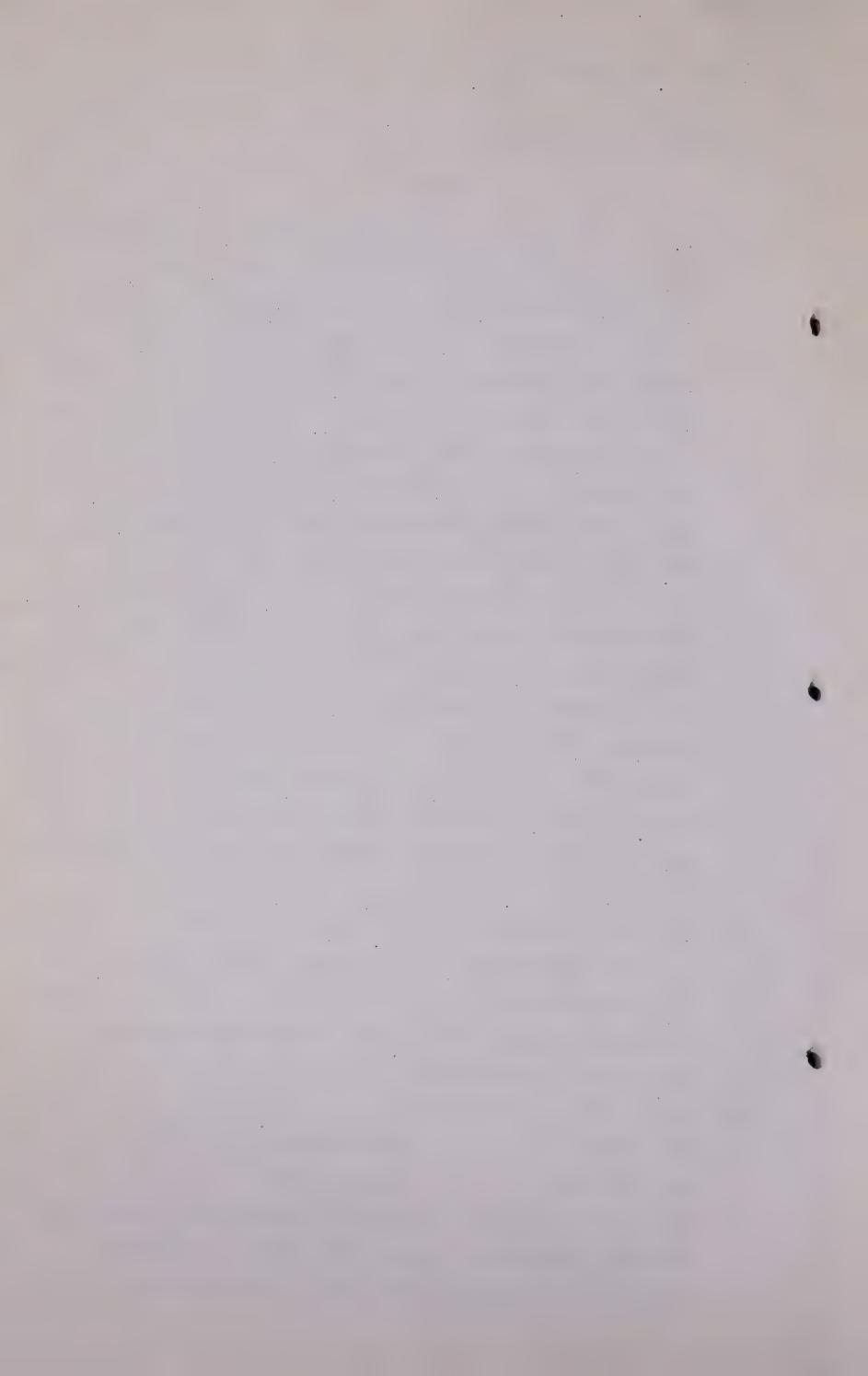
Would that be more or less accurate?

A That would be satisfactory.

MR. STHER: Whose definition is that?

MR. CHAMBERS: I do not know.

That is this science of economics I understand is concerned with the activities of man in the process of earning a living and applying his income to the satisfaction of his



A. Stewart, Cross-Edam. by Mr. Chambers.

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Now Smith said this: - and while he talked about natural liberty I submit that was not the whole story. Do you recall these words? I have them here for that matter and I will quote them to you first. He says:

"Consumption is the sole end and purpose of all production and the interests of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer."

Do you recognize that statement?

- A Yes. I get the drift the of it and I think I understand it.
- Then Smith also used the word or phrase "tolerable security".

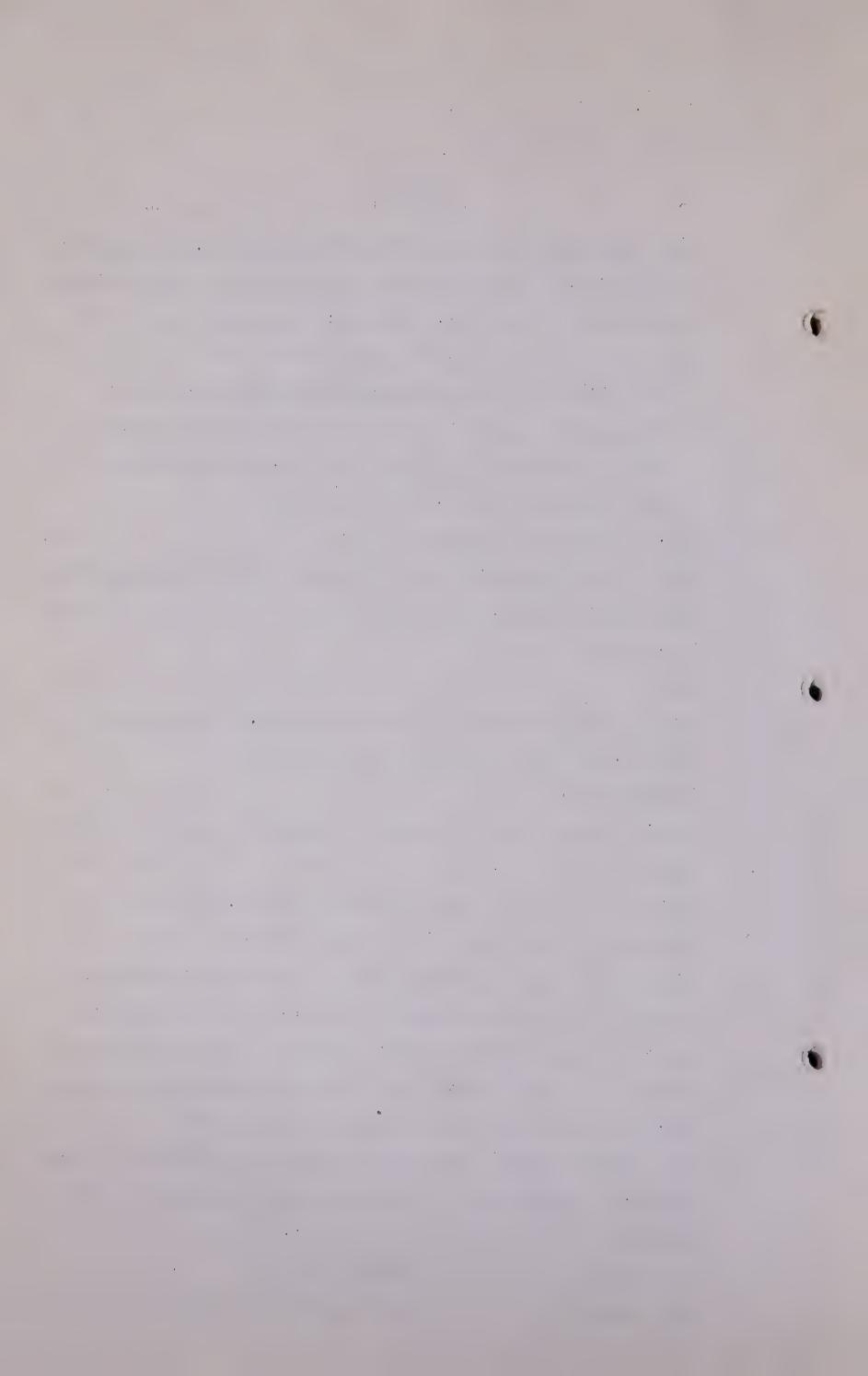
  Do you recall that?
- A Yes.
- Then following Smith, we had in England as I understand it stuart Mill came along and wrote a book.
- A In 1848.
- Q And he accepted self-interest as a mode of economic activity didn't he?
- A Generally speaking, although it is rather interesting that he also is a keen advocate of co-speration.
- or less of individual initiative being encouraged and if that was done everything else would more or less take care of itself. Would that be more or less a generally accurate summing up of what Smith and Mills advocated?
  - A Yes, that if people were left to their own initiative under forces of competition the results would be generally beneficial.

MR. STEER:

Laissez faire.

MR. CHAMBERS:

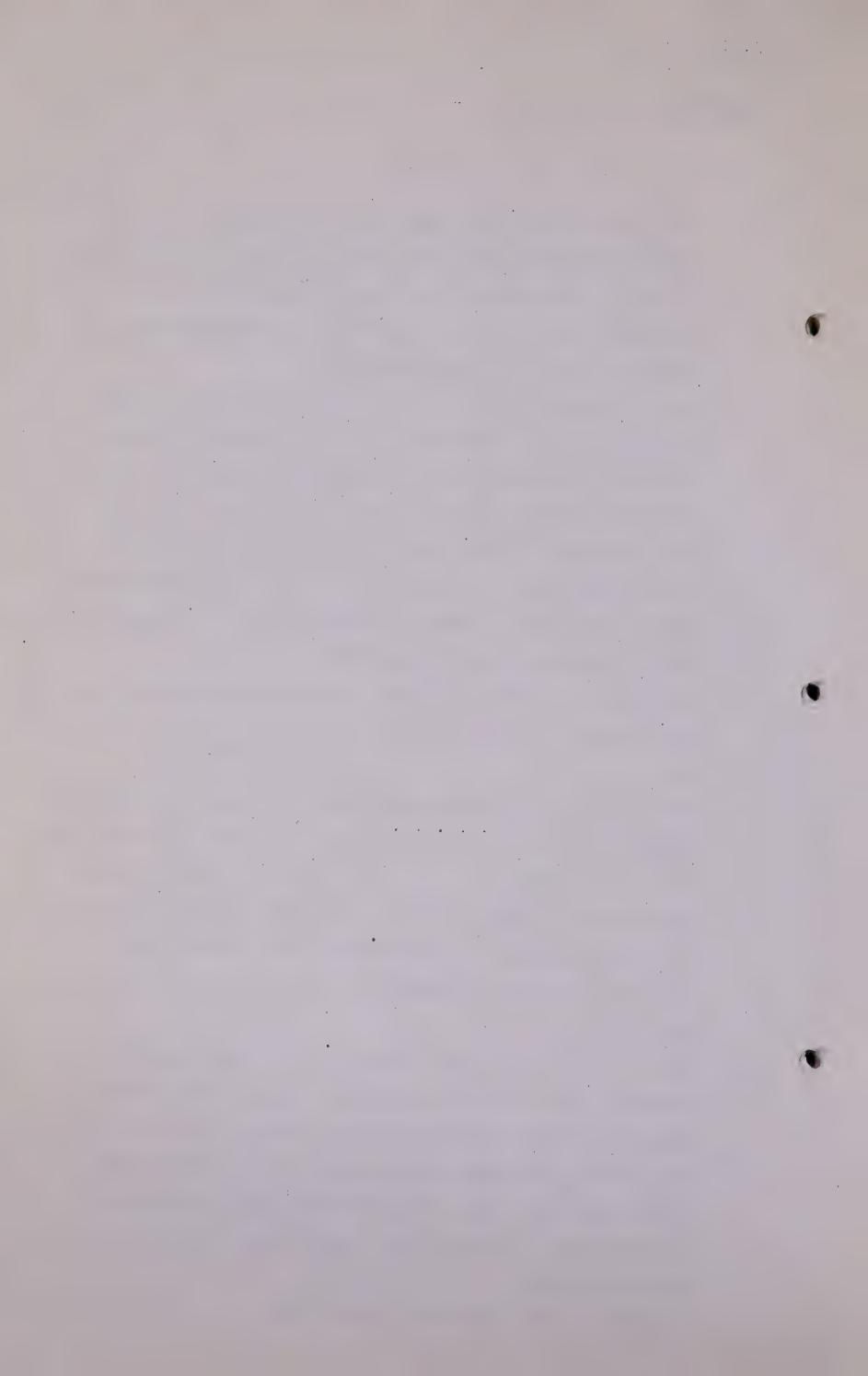
And then we have the other school



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that sprung up of which Marx is the outstanding advocate and that stressed, as I understand it, that the fundamental factor in the development of society was the method of production and exchange. Was that your understanding in a general way of what Marx advocated?

- Well the usual position taken, or interpretation of Marx is that he did not actually advocate anything, although I think his followers have picked on his treatment of the subject as a basis for a programme of action. But the usual statement is that Marx'discussion was descriptive rather than formative. He was not propounding procedure as much as analyzing a course of events which he thought would follow inexorably on the conditions prevailing.
- Q But he in any event started it, whether he intended to or not, that is what he started off?
- A Yes.
- Now so much for the background of this thing. The fact remains that since these men wrote experience and conditions in these countries . . . . and I am still talking about Anglo-Saxon countries have, I suggest, taught that there are certain types of undertakings or businesses which are affected with public interest. Would you agree with that statement?
- A Well it seems to me, Mr. Chambers, that everything is affected with the public interest. but so far we have selected certain types of activities which are dealt with in a rather different way because they are affected by public interest. But I do not think that that is an exclusive term. It seems to me everything is affedted by public interest.
- I suggest, going back again, that even



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Smith went that far didn't he? He said if you look after the interests of the consumer and you look after it in the real sense of the word that you look after the interests of everybody, producers as well. But that the main interest was the consumer. Do you say, therefore, that Smith thought what he was suggesting was in the public interest too?

- A Yes, I am sure he did.
- Let me put it this way, that at least experience has taught us in the United States and here and in the Old Country that there are certain undertakings which have become to be regarded in the public interest and have to be dealt with or should be dealt with in a special manner. Would that be a fair way to put it?
- A Yes. Types have not been rigidly defined I do not think.

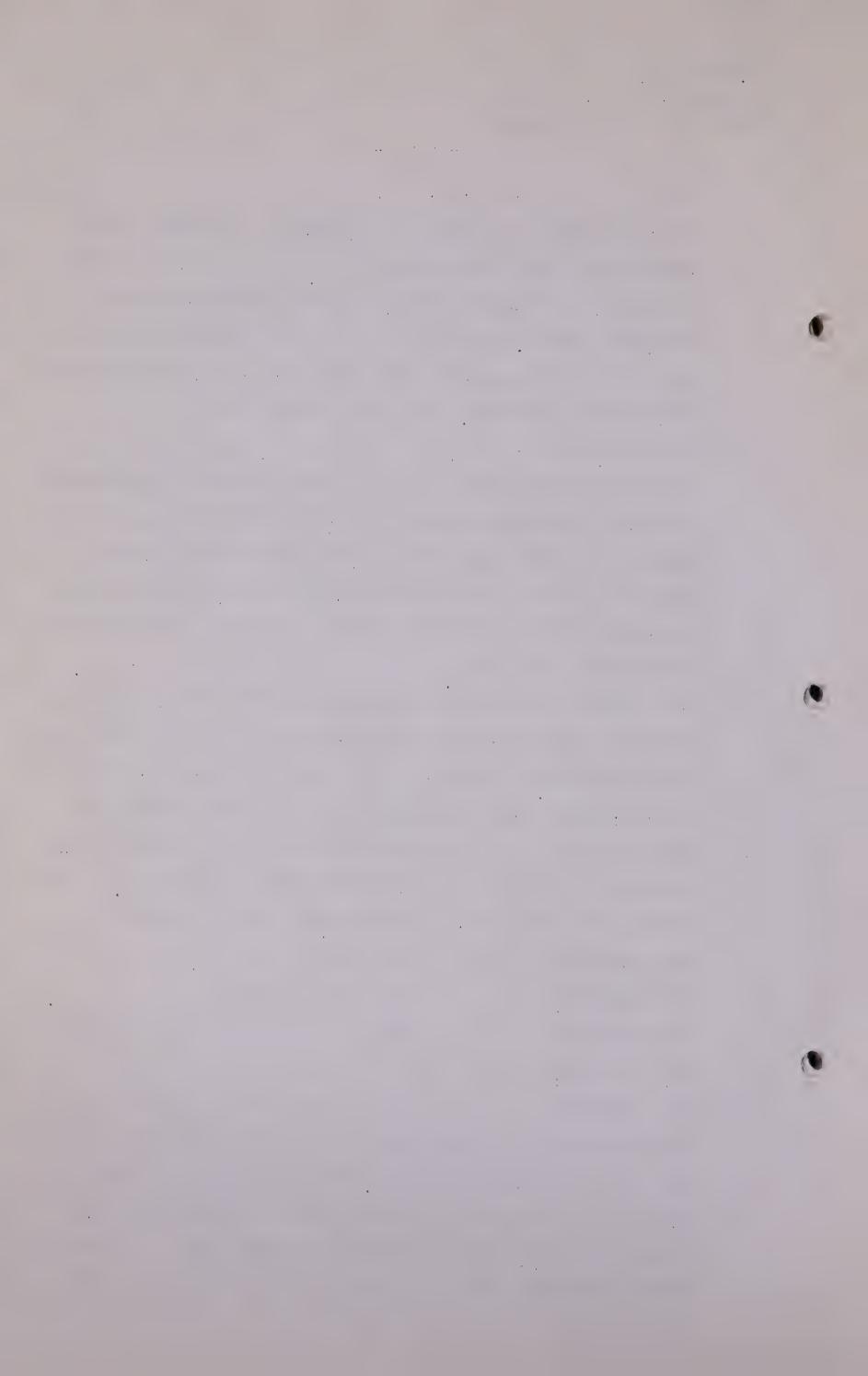
  At least there seems to be an extension of the principle to include different types of activities and business. That is it seems to me that the idea of what is affected with the public interest is a growing idea rather than a static one.
- In other words our ideas on these things change and the scope widens as we have had experience over the last years.
- A That seems to be a fair description of it.

THE CHAIRMAN: Plus social progress.

MR. CHAMBERS: That is social progress I suggest.

THE CHAIRMAN: Specifically.

O MR. CHAMBERS: Now in the past some of the characteristics of these undertakings that have been regarded as - have been specially regarded let us say as being in the public interest are these. One was if a company or organization had power over public domain, that is forcibly taking property. That was one of the characteristics of a



A.Stewart, Cross-Ex. by Mr. Chambers.

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company that was affected by public interest was it not?

- A I believe so, yes.
- And then the undertakings that in their very nature were monopolies were among the first to be regarded as in the special class of being specifically affected with public interest.
- A. Yes.
- Of the entire community of locality are directly concerned in the manner in which a public utility is operated, it has been considered in meny cases necessary in the public interest that certain duties and obligations be imposed on it. Would that be your understanding of what . . . .
- As far as I can interpret the evidence that I see, Mr.

  Chambers, it is simply that in certain circumstances, not as
  I see it very clearly defined, the Legislature which has the
  power to do so determines that certain activities will be
  put under regulation. Now I am not sure that I am in any
  position to say why they do that. I am certainly not in any
  position to say whether it is legally proper procedure or not.
  I merely observe that there are a wide variety of activities
  which are brought under regulation.

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- Yes, but your observation leads to this conclusion, I mean the observations you have made of the various steps that Governments have taken in the past to pass legislation to make certain undertakings public utilities, has your observation led you to this, that practically all of those undertakings in their nature and effect generally are monopolistic?
- A I think that is true of every one but I do not think that that is sufficient explanation, and even on the grounds of a monopoly I can see Government control operating in competitive fields, so that I do not know that that in itself is sufficient explanation for this intervention.
- Q But at all events the legislature in many cases has set up system of regulation for certain undertakings and we usually refer to those as public utilities?
- A. Yes.
- Q Yes, and you are familiar with the phrase that the utility and its property is then said to be devoted to the public service?
- A Yes.
- And the Legislature, or the reason I suggest to you for that action of the Legislature, is that the Legislature rightly or wrongly has decided that the business is one especially affecting the public interest and is one where the general public welfare outweighs the private and individual enterprise, would that be a fair way to put it would you say?
- A Hardly, I think, Mr. Chembers.
- Q All right?
- A In the first place I am not in a position to interpret the intentions of the Legislature. I merely see that they do certain things and that is significant to me as an economist.

MR. FENERTY:

I wish you would make clear to

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the witness what public you are talking about, if you intend to pursue that.

MR. CHAMBERS:

I am including part of my public here, no doubt about it, the City of Calgary.

MR. FENERTY: You are including those but you

are including everybody else in the Province?

A I do not know whether this will help or not, but as I state in the brief here:

"Legislative selection of enterprises to be brought under public utility control implies first, dissatisfaction with the manner in which, in the particular case, the function may be performed in the absence of regulation; and second, regognition that, in the particular case, the service rendered is sufficiently important to warrant regulation in the public interest."

- Q. MR. CHAMBERS: Well then, in other words it would be fair to say the Legislature in any case has decided that things should not go on the way they have been going on?
- A That is right.
- Q. And by legislation they change the future operations?
- A It might so happen, yes.
- Well now, I suggest to you this, Professor Stewart, in the light of the discussions which we have had and I am asking you whether you agree, that it is in the public interest to have tolerable security for capital as well as for labour?
- A I think the effect of that would be desirable, yes.
- Q Yes, and will you also agree with this that it is in the public interest that capital and investment should be encouraged to be employed in new development and expansion?
- A Within limits, yes, but we do not want undue investment to the detriment of the immediate consumer.

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Andrew Stewart, Cr. Exam. by Mr. Chambers.

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- Q Yes, and that, would you agree with this, that public interest is, in the last analysis, the interest of the consumer?
- A Yes. I would qualify that, I think, if I might presume to do so.
- Q. Yes?
- A Adam Smith's proposition, that there is no end to the production itself. I would agree with the statement generally speaking, wherein the services which flow from production, is in the consumption of those things, that I also would say that we do derive some of our satisfaction from the activities that we engage in and that is an important consideration too, and to that extent the producers point of view enters in as a separate consideration, but by and large we are interested in the production as a means to our consumption and to the satisfaction of the consumer.
- Q Yes, it leads to this end and the end is the welfare of the consumer?
- A Yes, subject to that minor qualification which I stated.
- Q Yes. Now, I further suggest to you, Professor Stewart, and
  I am asking you whether you can agree and if you can not, I am
  asking you to qualify it, that at least under our present
  economic system it is in the public interest and by that I mean
  in the ultimate interest of all the consumers.....
- A Yes.
- Q That private capital be not subjected to the fear or hazard that, having embarked on an enterprise, either that that capital or the fruits of it, may be taken away or injuriously affected except on a basis of due compensation.
- A I think I agree with that. The fear of eviction or loss as a result of actions of that kind, would limit the extent of the investment. It would then reduce the flow of service and that

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would be detrimental to the consumers' interest, within the existing framework of our society where we are depending upon private capital investment for producer goods.

- Q Yes, in other words, so long as we have the capitalistic system?
- A That is right, yes.
- Would you go with me, would you agree with this, that the basic rule of our law that all are equal before the law and are entitled to the same protection by the law, is not only morally and ethically sound but it is economically sound, as conducive to the ultimate welfare of the consumer?
- A Well under our institutions of society, I would agree with the last part. I do not know about the first.
- Q Well, assuming that the law is that, would you agree that it is good economics?
- A Good economics, yes.

THE CHAIRMAN:

Is that the common law or tho

statute law, Mr. Chambers?

MR. CHAMBERS:

It is the statute law too, unless

the Legislatures step in very definitely and say otherwise.

THE COURT:

I thought perhaps you were working

upto that, how this statute was framed.

MR. CHAMBERS:

No.

WITNESS:

I wish you' were.

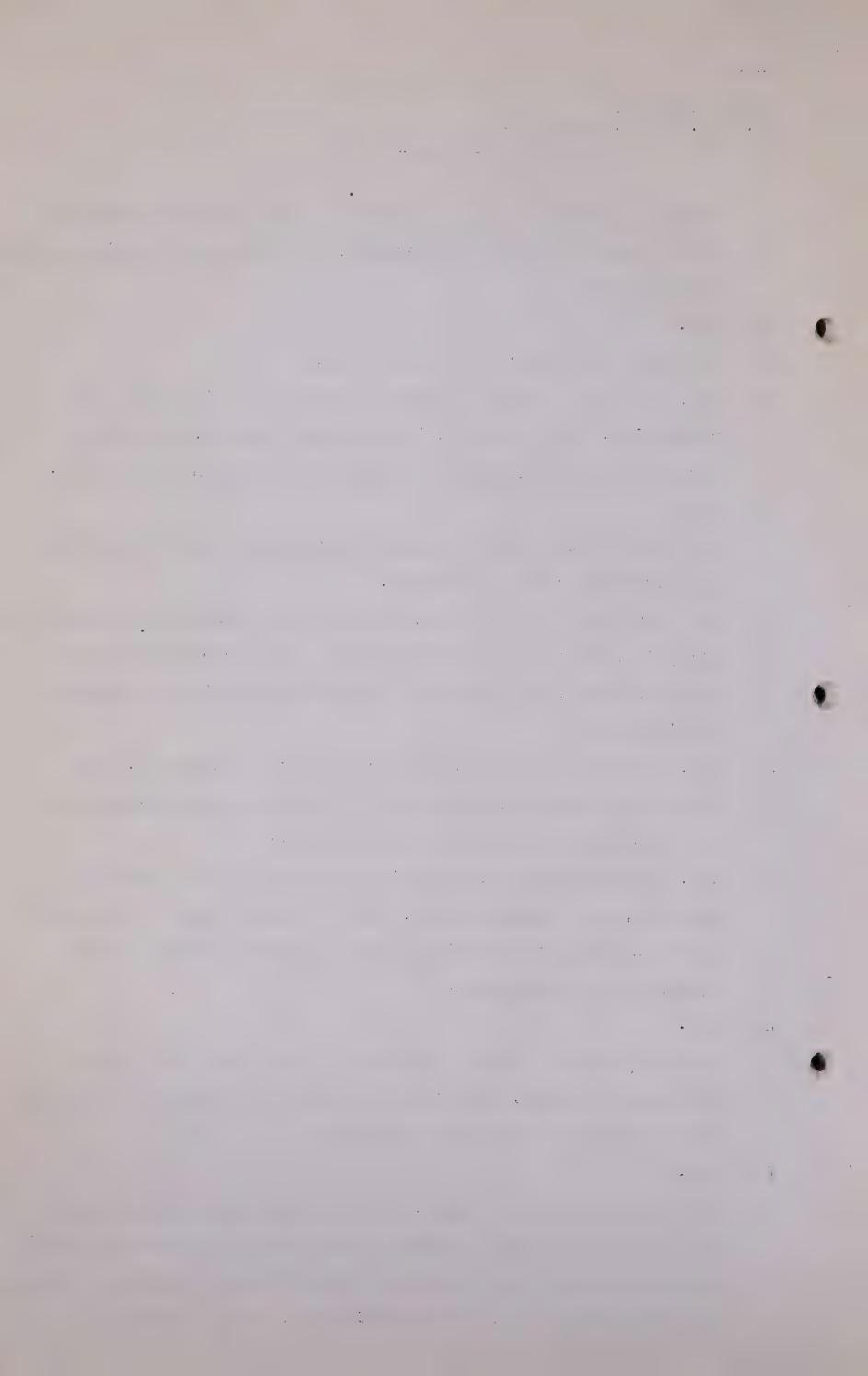
Now on turning to your exhibit 131, Professor Stewart, on page 2, and I think you read to us a minute ago the part that I am going to refer to, you say there that enterprises are brought under regulation by the Legislature because in the judgment of the Legislature there is dissatisfaction in a particular case with the manner in which, in that particular case, the function may be performed in the absence of regulation or without regulation, and also because

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of the recognition that the matter is of sufficient importance in the public interest to warrant interference and the institution of regulation?

- A Yes.
- Q That is in effect what you say there?
- A Yes, and bythat I mean I take it that the Legislatures act rationally. They may not, but assuming they do, that they have a reason for making the change. They are not satisfied.
- Q Yes?
- A And that the case is sufficiently important to justify putting the situation under regulation.
- Q Yes? And then you say this, by means of regulation the public utility is substituted for the state in the performance of the public service, and that the public interest is the dominant consideration?
- A Yes, it is of course possible to conceive of anything, any activity as being in the nature of a public service insofar as it is serving the welfare of the public.
- Q Yes, but you qualify it here in the sense you are talking about it, as I understand it, that it is one that is recognized by the Legislature as being of sufficient importance for the Legislature to intervene?
- A Yes.
- Q And it is to the public interest in that sense that you are talking about here, what the Logislature has recognized or dealt with as being in the public interest?
- A Yes.
- And then on that same page, you talk about the public interest and theparamount consideration in this case, and that the public interest is winder than the mere interest of the immediate consumer; now I suggest to you, Professor Stewart, that, a fortiori, it

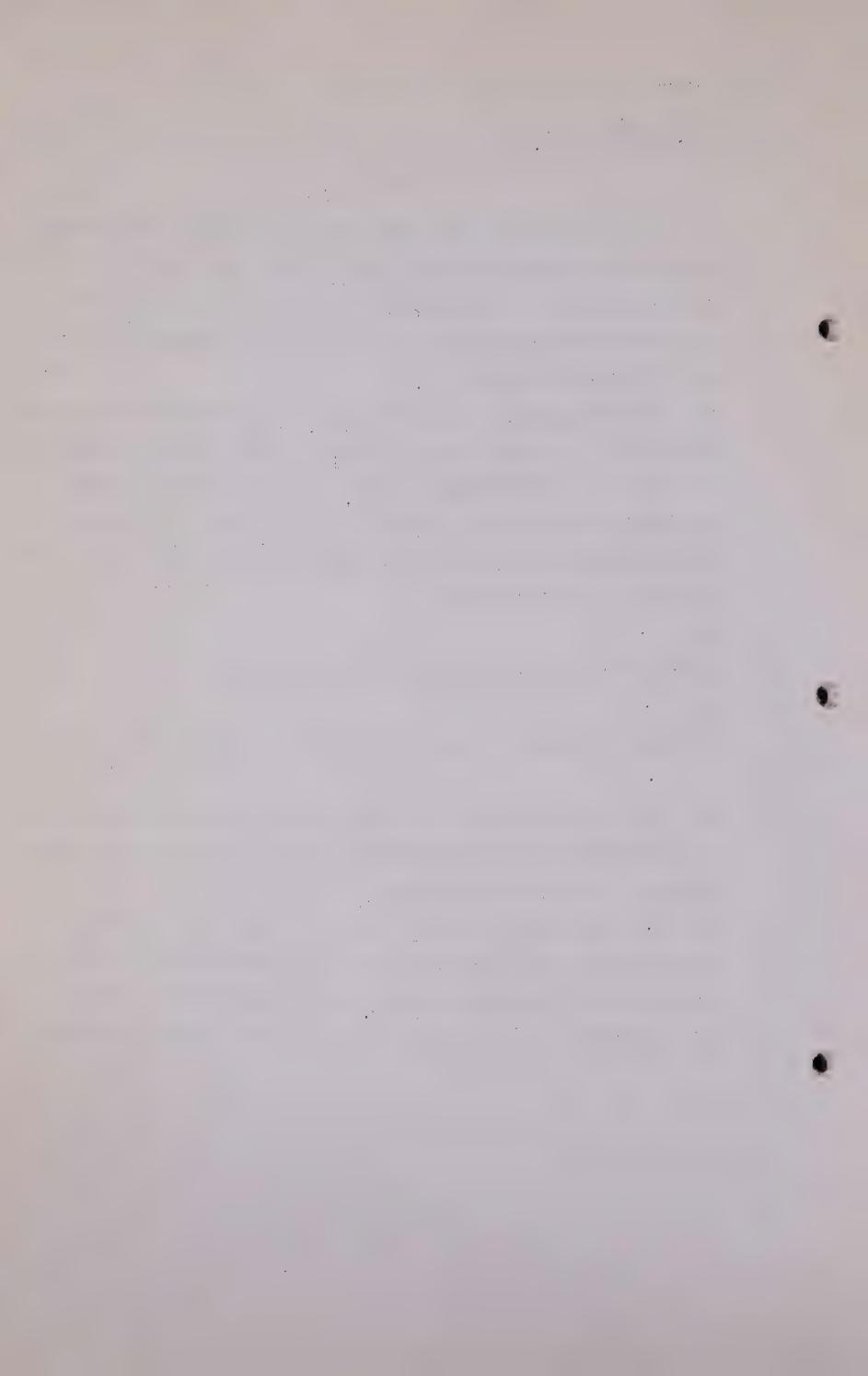


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is also wider than the mere interest of the present day consumer as contrasted with the one who may be here next year?

- A I think that we have to consider society as continuing, and
  we are interested not merely in the immediate consumer but the
  later consumer as well.
- Then on page 2, and I am reading, calling your attention to this, because there is another question that I want to build up on it, you state, as I understand it, that there is a wider public interest in the sense of first of all, the matter of a proper distribution of resources in alternative fields, that is a matter of public policy?
- A Yos.
- Q And also the promotion of general development?
- A Yes.
- Q You would consider that that is a matter of public interest too?
- A Yos.
- Q. Now would you also include in that phrase "wider public interest",
  the conservation of the exhaustible resources which are or will
  likely be of use to the public?
- A Woll, the word "service" is a very difficult one to give any proper content to. If by that you mean consideration of the advantages to the present user, then I think that is a valid consideration to be taken into account in the public interest.



Andrew Stewart, Cross-Examined by Mr. Chambers.

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- Q It is certainly an element to be taken into consideration when you are considering what is and what is not public interest?
- A Yes, the balance in the satisfaction immediately and those to be derived in the future.
- Now on Page 1 of your Exhibit 131 of your report you state in effect that regulation in the consumer interest implies that the requisite capital and resources should not thereby be diverted into other channels. That is a fair summary of what you say there?
- A I have not found the place Mr. Chambers.
- Q On page 1.
- A Would that be page 2 ?
- Q Yes, I am sorry.
- A I think so. The first function implies that the regulatory process should not distort the flow of capital and other resources.
- Yes, that is it. I am sorry. Now in the light of that statement or having that statement in mind I further suggest to you that it is not in the interests of consumers generally nor in the interest of the public in that wider sense, that the institution or the possibility of institution of regulation should be applied so as to destroy capital or other resources, of any unregulated enterprise, or which might conceivably at some future time be regulated. I state, destroy capital so as to deflect capital. Let me put it that way. In other words, the proposition I put to you is this, that under our economy as we have it, it is in the interests of the consumer in general and of the public that the institution of the possibility of institution of regulation should be so applied as not to destroy capital or other resources that has been

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Andrew Stewart, Cross-Examined by Mr. Chambers.

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embarked on under private enterprise. Do you follow my proposition ?

- A I am not sure Mr. Chambers. There seems to be two parts involved. One is the deflection of capital from alternative investment. Now that is what you have reference to?
- Q Yes.
- A Well now I am afraid I do not quite follow.

are consistently interpreted.

- The proposition I am getting at is this. That in the application of regulation for the first time it should be done in such a way that parties going into private business that is not regulated, but which conceivably might at some future time be regulated, that is under regulation for the first time under order, utility practice should be applied in such a way as not to scare or have hanging over the heads of capital going into private enterprise some adverse event that might happen to it in the future by institution of regulation?

  A The greater / so far as future investment is concerned is the factor of assurance or stability in the regulations and that the regulations are capable of consistent interpretation and
- The point I am getting at is when we talk about consistency you have two in mind. One is when regulation is once adopted or applied to any particular business or industry that the practice in that regulation should be more or less uniform or should pay attention to precedent in the application of regulation after it has been instituted. Would you agree with that proposition?
- A I think a large measure of stability is essential. On the other hand we can have no progress unless we have change and at some time changes may have to be made. At the same time

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Andrew Stewart, Cross-Examined by Mr. Chambers.

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they should not be erratic, otherwise you would destroy the essential confidence and assurance, but I think we cannot rule out the possibility of change, otherwise we would rule out the possibility of progress. But subject to that qualification, assurance is dependent both upon stability and consistency in interpretation.

- Now that you would say is important in applying the regulations from year to year to an enterprise already regulated. That would be an economic practice would it not?
- A I think it would be very unfortunate if the regulations were differently applied each year.
- Q Well now I am going back one step further. If in the application of regulation for the first time to a new business or new kinds of businesses, the practice grows up by the legislature or boards or otherwise that in instituting that regulation it would be done in an erratic manner or in a manner that does not give due compensation or fair value and I am not pinning anybody down to what that means at the moment if it is done in that way it affects capital going into private enterprise if it has hanging over its head this unknown hazard. What do you say as to that?
- Ye's, the uncertainty plus the experience of what is deemed to be confiscation would create an atmosphere not conducive to investment.
- And then on Pgge 3 of your Exhibit 131, you state that it is in the public interest that regulation should be applied in such a manner so as to include effective inducement to efficient management. Now what I am going to put to you is this, is not the most effective inducement the assurance that the fruits or profits of such efficiency of management will to a

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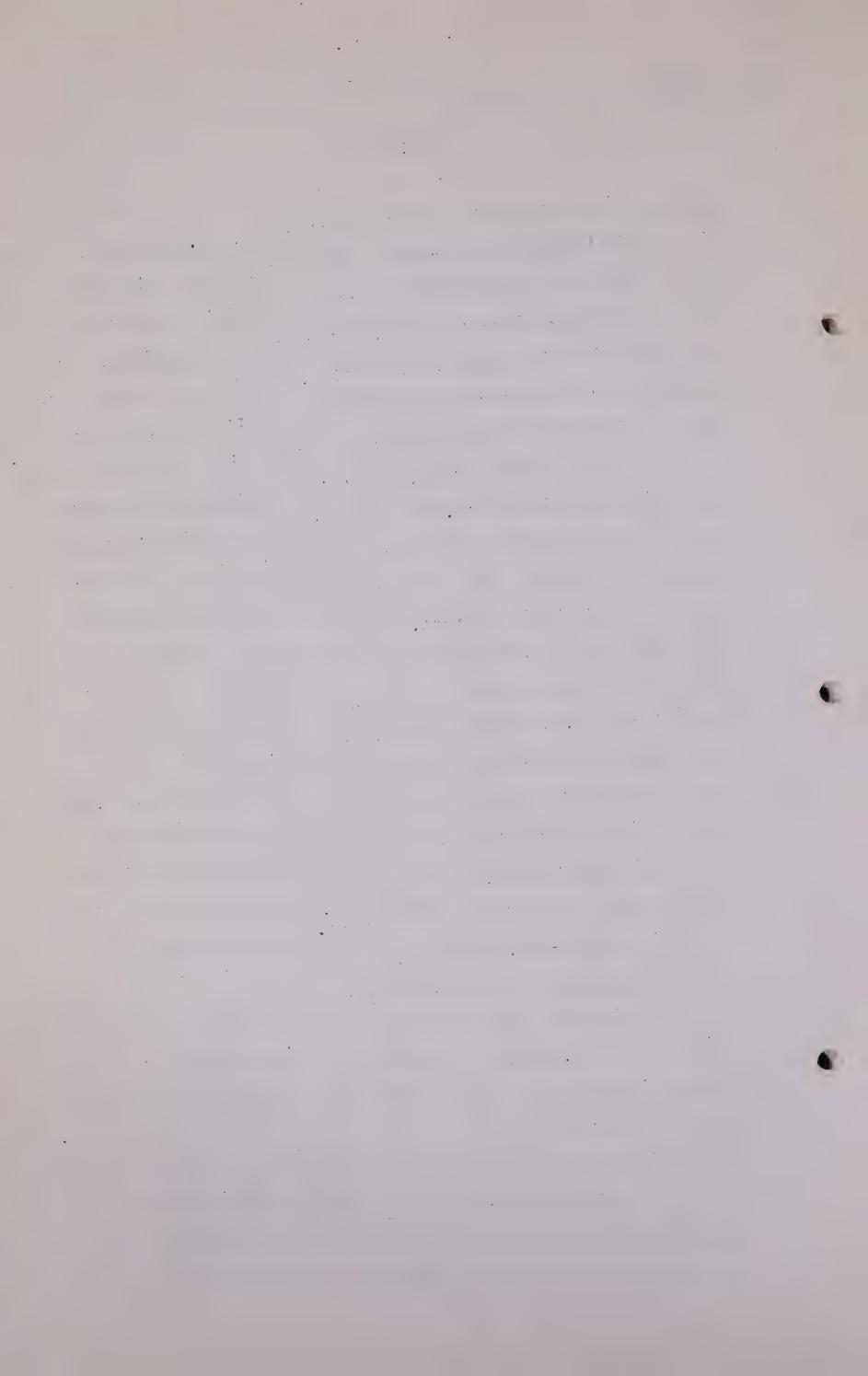
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considerable extent inure to the utility ?

- Well I draw a distinction between investment and management which I think is a valid distinction, Mr. Chambers, when you are thinking in terms of the provision of capital funds or investment then my contention is that the conditions must provide an incentive to the investment of capital, but by management I mean the operation, the day to day operation of the utility or company, and it seems to me today that there is a fairly clear distinction between the personnel of management and the investors. That is we really have two different groups to deal with. As I say it is essential that the investors receive inducement, but I think it is also necessary that those who are responsible for the day to day management also receive inducement.
- Q Well in the last analysis are not the common shareholders the ones responsible for the present day management?
- A I think not, under current conditions, but actually the large part of the decisions are left to salaried management, but eventually these come in review by the shareholders who have certain voting privileges and their responsibility is to select competent management, but the actual operation is largely that applied by management.
- Q But the Directors, would you say that the Directors come within your view of management or definition of management?
- A I think it would vary in circumstances. Mainly yes, probably in most cases, yes.
- Q Now I just want to get clear what you mean, or your meaning.
- A I put a distinction between incentive to inducement which is the thing necessary to provide funds and the incentive to make the daily operations efficient, which is more a problem



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of management and under present day conditions I think there is a considerable divorcing of these two functions.

- Well in any event do you mean this, the return to the investment or the reward to the investor, plus the reward for efficiency. Those two together represent what the utility as an
  organization keeps itself as distinguished from what the consumer gets. Is that what you had in mind?
- A No, I have in mind this, Mr. Chambers. That I think incentives are necessary two kinds of incentives. First an incentive to investment. The consideration there is the rate of return, but if I wish to provide incentives to efficient operation of a utility I would pay the management a bonus rather than through the rate of return.
- And when you talk about paying the management a bonus, are you meaning or suggesting that that should be wholly taken up by giving the employees a percentage of some of the earnings or what have you particularly in mind?
  - I have in mind this, Mr. Chambers, Mr. Chambers has made me finally commit myself on some phase, but I have in mind if we can find the people in an organization who are really making the management decisions and my point is that in many situations these are not the shareholders. At least not the majority shareholders. But if we can find the people who are making the day to day decisions in regard to management they are the people who are important in regard to the efficiency of the operation of the business and that the bonus paid to them would have a larger effect on stimulating efficiency of operation rather than an increase in rate of return would have.

    MR. FENERTY:

    I hope they do not hear about this down in Windsor.

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Andrew Stewart, Cross-Examined by Mr. Chambers.

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- Q MR. CHAMBERS: Would you agree with this proposition,
  Professor Stewart, that regulation should not be so instituted or applied and I am talking about in the first instance,
  so as to deprive investors or management of the fruits of
  efficient management, prudence or risks, practices or undertakings prior to regulation?
- A I wonder if you would repeat that ?
- Q Would you agree that regulation should not be so instituted in the first instance so as to deprive investors and management, I am putting them both together, of the fruits of their efficient management and of their prudence or their risk that has been practiced or undertaken by them prior to regulation?

  A Yes I agree with that.

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THE CHAIRMAN: What would you call "fruits"?

MR. CHAMBERS: Rewards.

THE CHAIRMAN: Does that include unearned increment?

MR. CHAMBERS: Yos, certainly.

A THE WITNESS:

Well, it seems to me there are a number of terms in there which need definitions. Subject to the definition of them, I leave it as a general statement.

Q MR. CHAMBERS: Well, then in short you, I take

it, as an economist, would agree that it is in the public interest

not only to avoid but also to eliminate this fear of confiscation?

- A Yes.
- And by the term "confiscation" we mean in the sense of taking away or deprivation without due compensation of the rights and benefits lawfully acquired by a subject or a group of subjects or persons, I should say. Would you agree with that?
- A Subject again to the definition of terms, yes.
- Q Yes. On page 9 of your report.....

THE CHAIRMAN: Would this be a suitable time

MR.CHAMBERS: I think perhaps it would, Sir.

(At this juncture a short adjournment was taken).

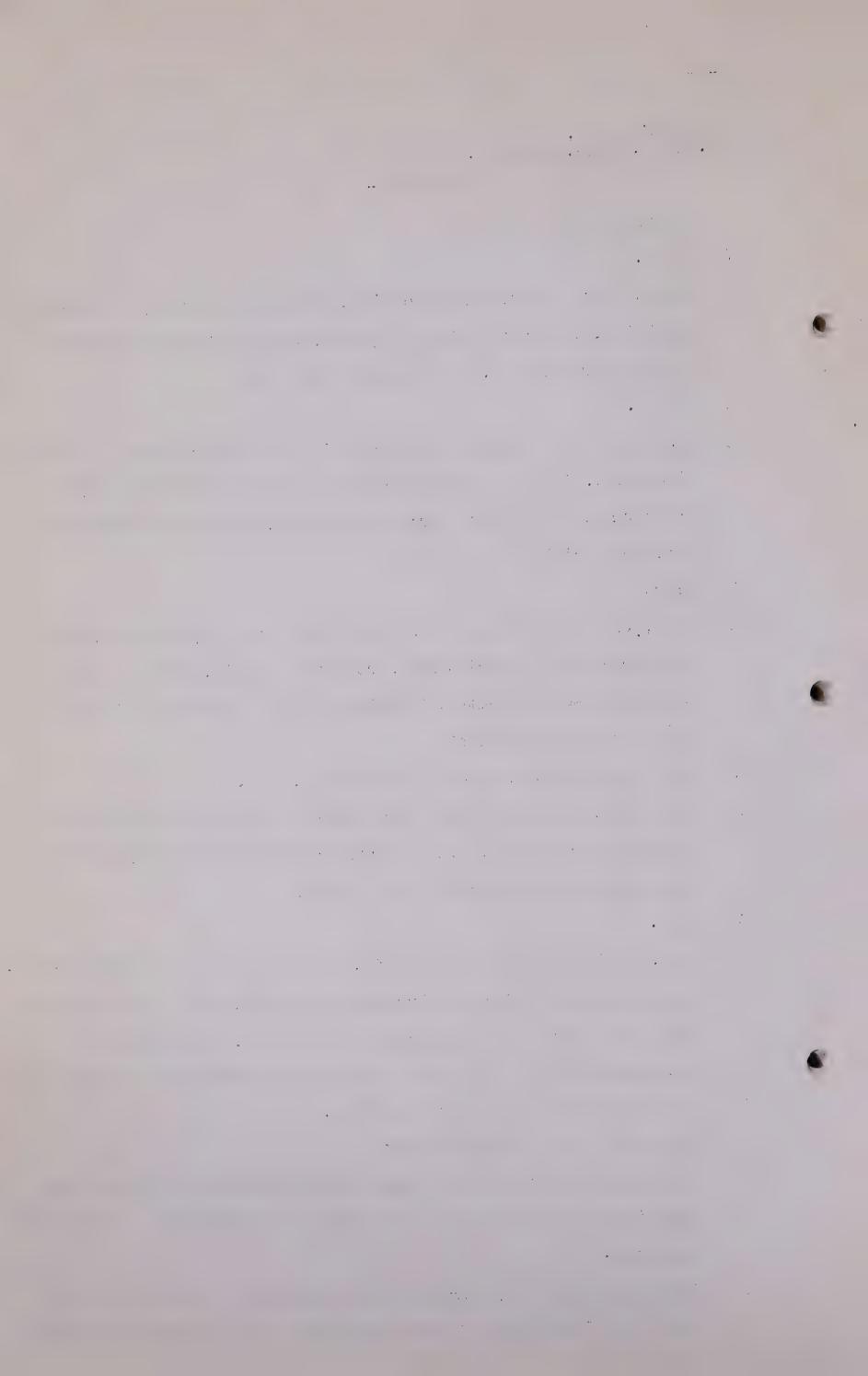
Q MR. CHAMBERS: Professor Stewart, will you turn to page 9 of your report, which is Exhibit 131, I think it is about the fourth paragraph there, where you state, as I take it in effect that it cannot be expected that the results under regulation will conform to the results reasonably expected during the period prior, or the prior period of absence of control. I, therefore, suggest to you that Party "A" making be his investment in a private enterprise, and it should/unregulated enterprise, expects one set of results and makes his investment on that basis. That would be a proper proposition

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would it not?

- A Yos.
- Q On the other hand investor "B", placing his money in a regulated utility, expects a different result which is predicated on regulatory prices. Do you agree with that?
- A Yes.
- And one of the results expected by "A" in investing in a private business, is that he will reap all the benefits and rewards of appreciation upon a rise in prices, and he will expect to take the risk of any drop?
- A Yes.
- Q Now, on that same page 9, I take this to be your view, that conformity to expectations, reasonably held, appears to be a significant attribute of "fairness" in connection with the process of regulation?
- A That appears to me to be reasonable, yes.
- Q Well now, should not that principle be fully recognised and given effect to when the investor's property is being brought under regulation for the first time?
- A Yes.
- Q Now, would you agree with this, that the cost of a compressor bought and paid for and installed in 1938, say, that has been unused but has been kept ready to run, is, I suggest, no criterion of the 1945 value of that same compressor installed?
- A It depends what you mean by value.
- Q Well would you elaborate that?
- A That would be one of the conceivable measures of value, the question whether it is a reasonable measure for particular purposes.
- Q Can you tell me any circumstances that have occurred to you where the 1938 cost of that compressor would be the criterion

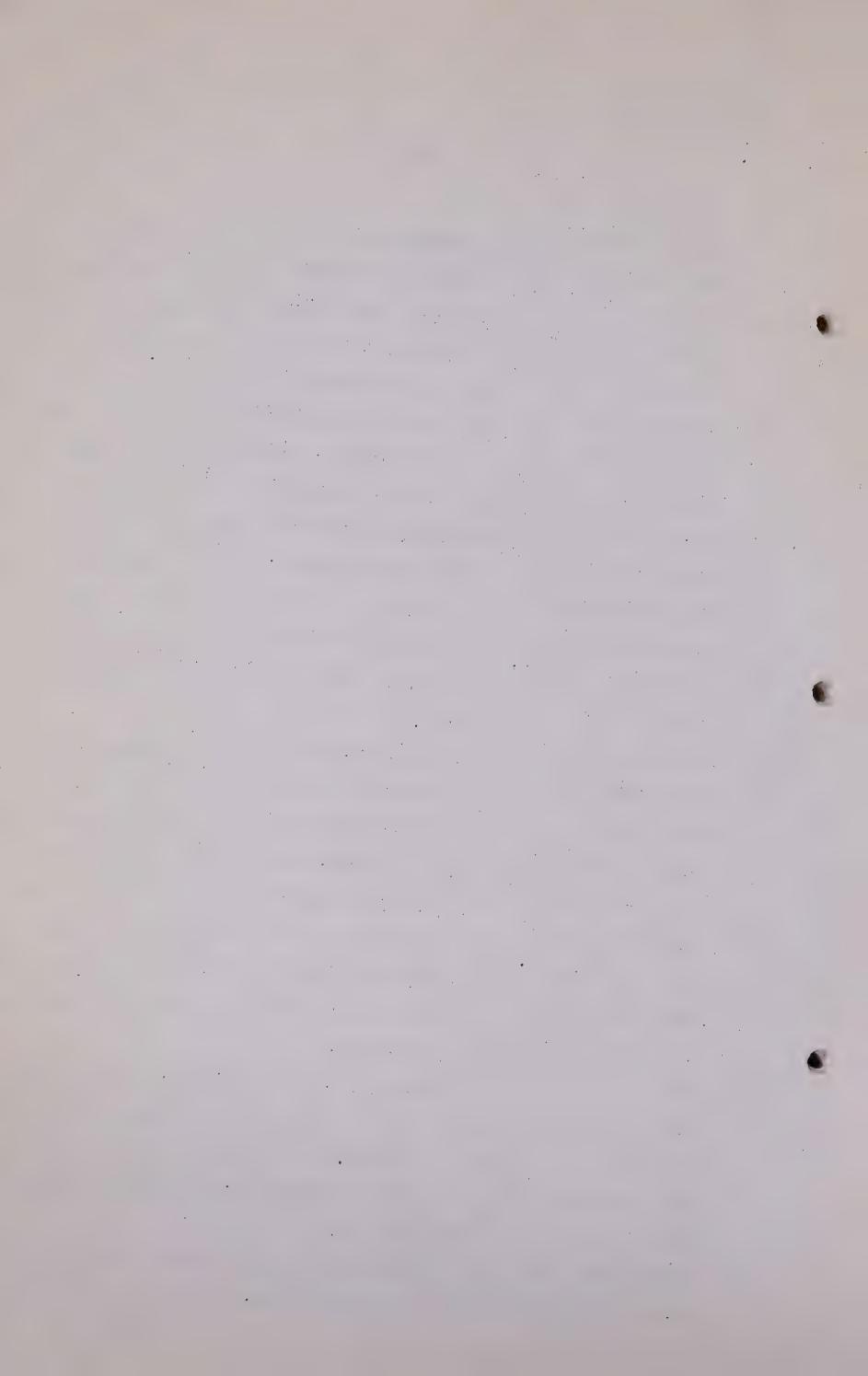


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to use for value in 1945?

- A Well, assuming that investment in this particular piece of equipment had been wisely made for the particular purposes, and if it were understood that at any time of any valuation to be made that that would be taken as the relevant value of the equipment, then I would say that would be reasonable to take.
- Assuming that the compressor was bought and installed in 1938 by a utility which was then under regulation, already under regulation, and assume that the practice has been established that prudent investment was to be used, prudent practice, in estimating or recomputing the rate base in 1945, would you under those circumstances say that the 1938 figure might be taken as the proper value in 1945, would that be a fair way to put it?
- A If it were clearly understood at the time of investment that that is what would happen in '45.
- Well then, going back to that question, we will assume that this compressor in 1938 was bought and installed by a company that is not under regulation, that the compressor has not been used but kept there in good shape, ready to run, so that today in 1945 it is just as good as it was, or just as good as though it was installed today, now, I suggest to you that in 1945, we will say, when that private business is being regulated for the first time, that that 1938 cost is not a proper criterion for arriving at a value under those circumstances.
- Well, I think in the first place, Mr. Chambers, that it depends upon what the reasonable expectation as to the basis of valuation would be at the time of investment. It depends further on other considerations which you have not introduced, but which might be relevant in the particular case.
- Now, I would like you to elaborate on that because the reason I asked the question is to get your benefit, get the benefit of your



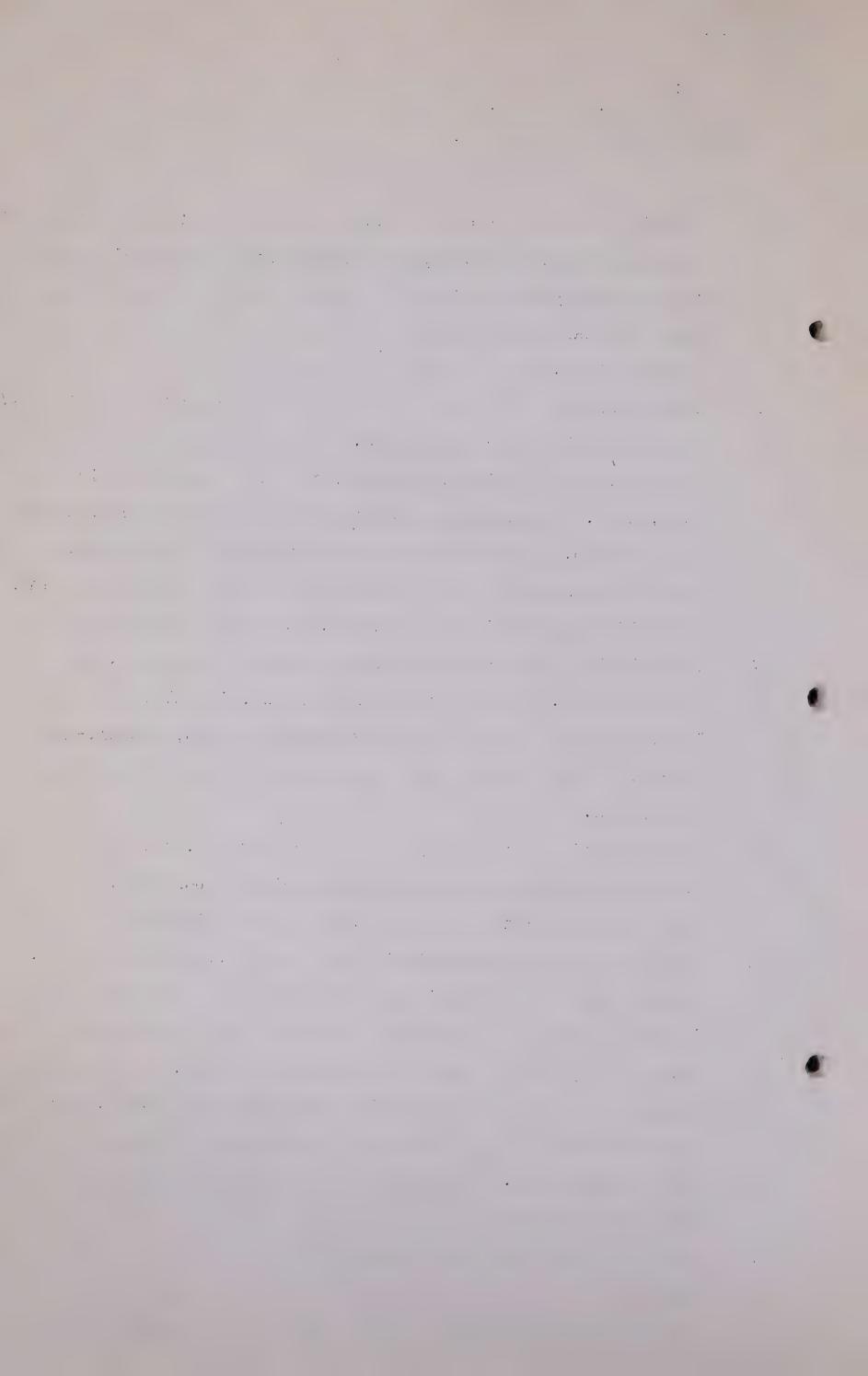
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views?

- A Certainly the factor of obsolescence should be taken into account.
- Q I am assuming that the type of engine would be exactly the same type as put in today?
- A And there has been no change in technique?
- a That is right.
- A I think also it is a question of the future use of the equipment.

  which could be expected in 1945.
- Q Well now, supposing on regulations being introduced in this year, 1945, we will assume for the moment that that compressor is not there, and you would have to have a new one put in?
- A What do you mean by "you would have to have a new one put in"?
- Q It would be needed in the business, needed to do the job?
- A It would be impossible to provide the service without.
- Q That is right. If you put the new one in, instal it now in 1945, you would have to pay present-day figures, present-day prices, wouldn't you?
- A That is so.
- Why shouldn't this same type of compressor new, put in in 1938 by a company when it was under private operation, why shouldn't that company now in 1945 get 1945 figures?
- My answer would be that if the equipment had been installed in '38 and if over the subsequent period of operation to 1945 the company were able to recover the '38 investment, there would be no reasonable ground necessarily for criticism of that, provided that at the time of investment the utility understood that that was the position.
- Q Knew what the rules were going to be?
- A Yes.
- Q I rather gather from the general tone of your report and what you



have said, that you think it desirable that there should be a general or well-known rule adopted as to what is to be applied for the first time when you bring a business under regulation?

- A I think that is essential to an assurance on the part of the investor, subject to the qualification that if you want to make progress you have to make a change sometime, but there should be reasonable stability and consistency in these rules.
- Assume in the absence of any such well-defined rule, would you agree that the cost of the hypothetical compressor put in in 1938 and paid for in 1938, would not be the proper criterion in arriving at a valuation in 1945 on the institution for the first time of regulation?
- A Well, if the investment were made under conditions where the rule apparently was that on a subsequent appraisal the current price would be used, then I think there is a strong case for the use of current prices.
- Q Well now, assuming there were no definite rules, nothing laid down, what would you say?
- A On the whole, I think that if the company is able to recocer the amount it has actually invested, I do not think there are any reasonable grounds for it.

(Go to page 4358. ).

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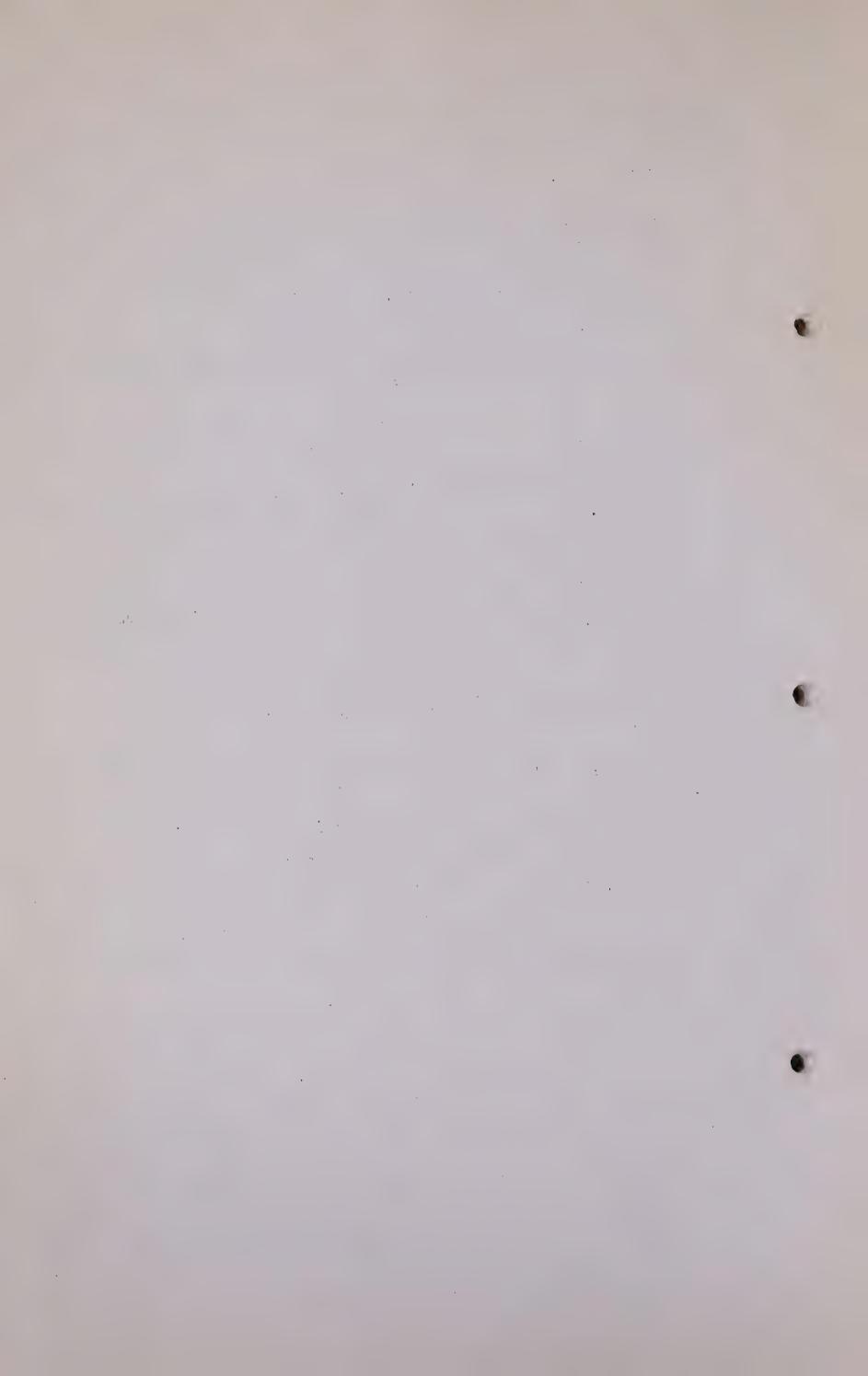
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- Yes, but are you suggesting that if it had written off or fully depreciated that item on its books, that is if it had not used it, that you should take the book depreciation off in order to get the 1945 value?
- A I would not recommend necessarily taking book valuations at all.
- Q Then what do you mean when you say that the company had recovered its investment.
- Well, would it have an opportunity to recover its investment.

  That is at the time of appraisal if the terms under the appraisal are such and the returns allowed are such that it could over the remaining life of the plant recover its investment, I see no serious objection to that basis of valuation.
- Q You mean could recover its 1938 investment.
- A Yes.
- In other words then would you say that under circumstances such as we have outlined, no definite rule, no regulation in 1938, the company having put in a new compressor and paid for it in 1938 at 1938 prices, now in 1945 when it is brought under regulation for the first time should only be allowed in the rate base the 1938 figure. Is that your recommendation?
- A I think that basis for valuation would be adequate under the circumstances you have assumed. That is when the Company makes its investment in 1938 all it could reasonably expect will be that it will get its investment returned.

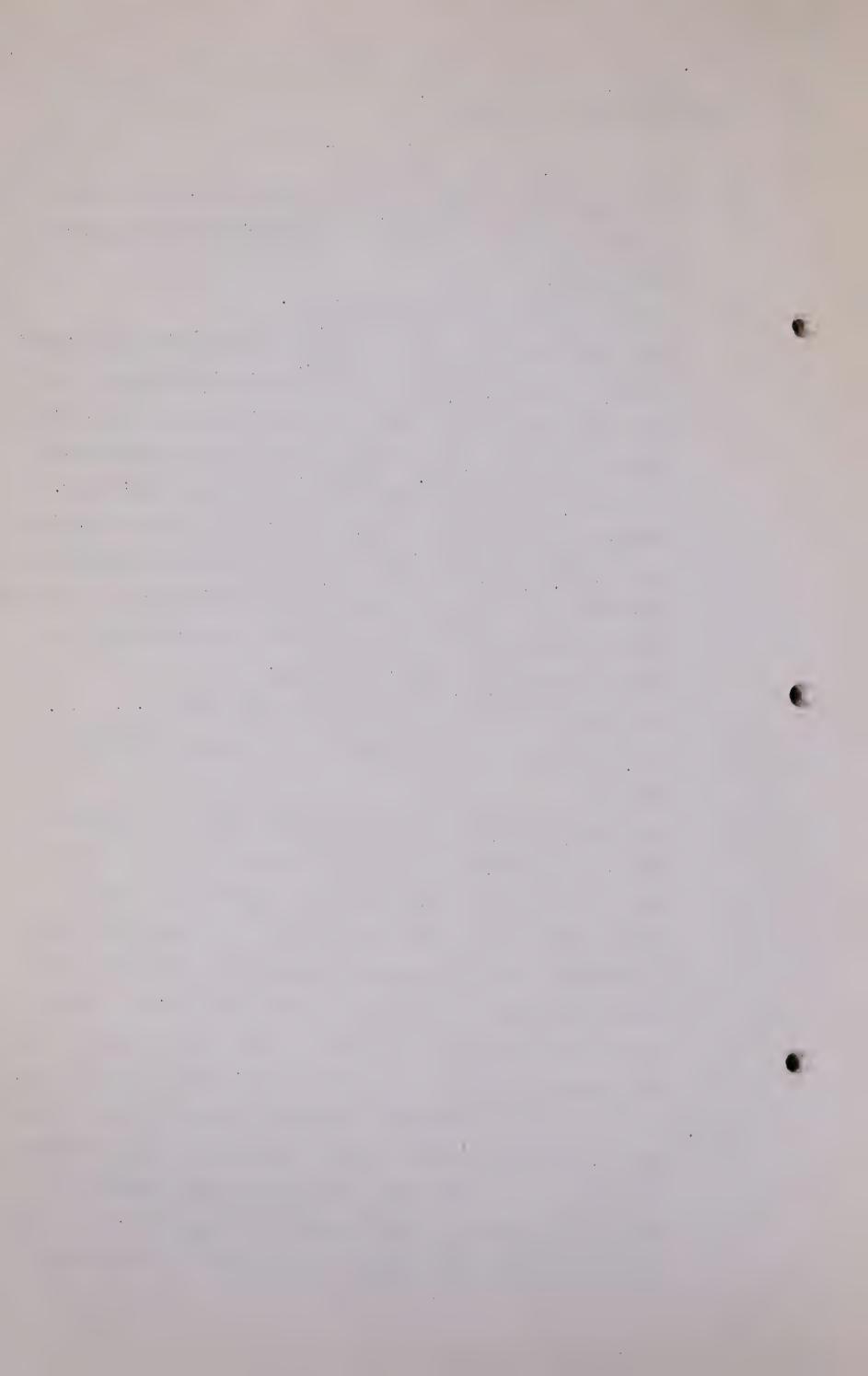
  Now that, I take it, is adequate incentive to induce the investment at the time. Therefore if those conditions are met it seems to me to be a satisfactory arrangement so far as the utility is concerned.



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- Q Yes, but in 1938, under private operation, it would also expect to get the benefit of any appreciation in prices would it not?
- A Only if it disposed of its assets.
- Yes. And your view would be that it would be fair or that it would be in conformity with its expectations that if in 1945, on being brought under regulation for the first time, that all it should expect would be the original 1938 cost?
- A I think that is right. You might notice of course, Mr. Chambers, that if the appraisals were made, not in 1945 but say in 1952, the tables might be turned so far as prices are concerned. Any reasonable basis for the selection of present prices assumes that these are variable and that there are periods of both high and low prices.
- As I recall in your report at some later stage . . . . .
- A. I can state my position I think in the report fairly briefly.
- O Yes.
- It is that assuming the principle of reasonable expectation that if the appraisal is made in a period of high prices, that is in a period when prices are higher than they are at the time of the investment, and if the subsequent basis of appraisal is still current prices, then the grounds for initial appraisal would be on the basis of present prices because while your valuation may be high at that point, it would later be reduced when prices fall. On the other hand, if in the initial appraisal, during a period of high prices, that is followed by the procedure of actual costs, then you are fixing in the rate base that high current appraisal which is due merely to the timing of the appraisal. It seems to me that that is too large a concession to the investors



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to follow that procedure.

Now would you please turn to page 25 of your report. In the first paragraph, you say:

"The direction from which the movement to bring the business under regulation is initiated, then becomes relevant. Assuming immediate determination of the rate base, if the business is brought under public utility control by legislation introduced during a period of relatively high prices, it might seem to be 'fair' to present investors to determine the rate base by reproduction costs. On the other hand, if a business is brought under control in a period of low prices, it might 'fairly' claim the more favorable original cost.

This leads to the conclusion

that in 'fairness' - " - and you quote the word fairness 
"to present investors when regulation is imposed by

legislation, the utility might be permitted to select

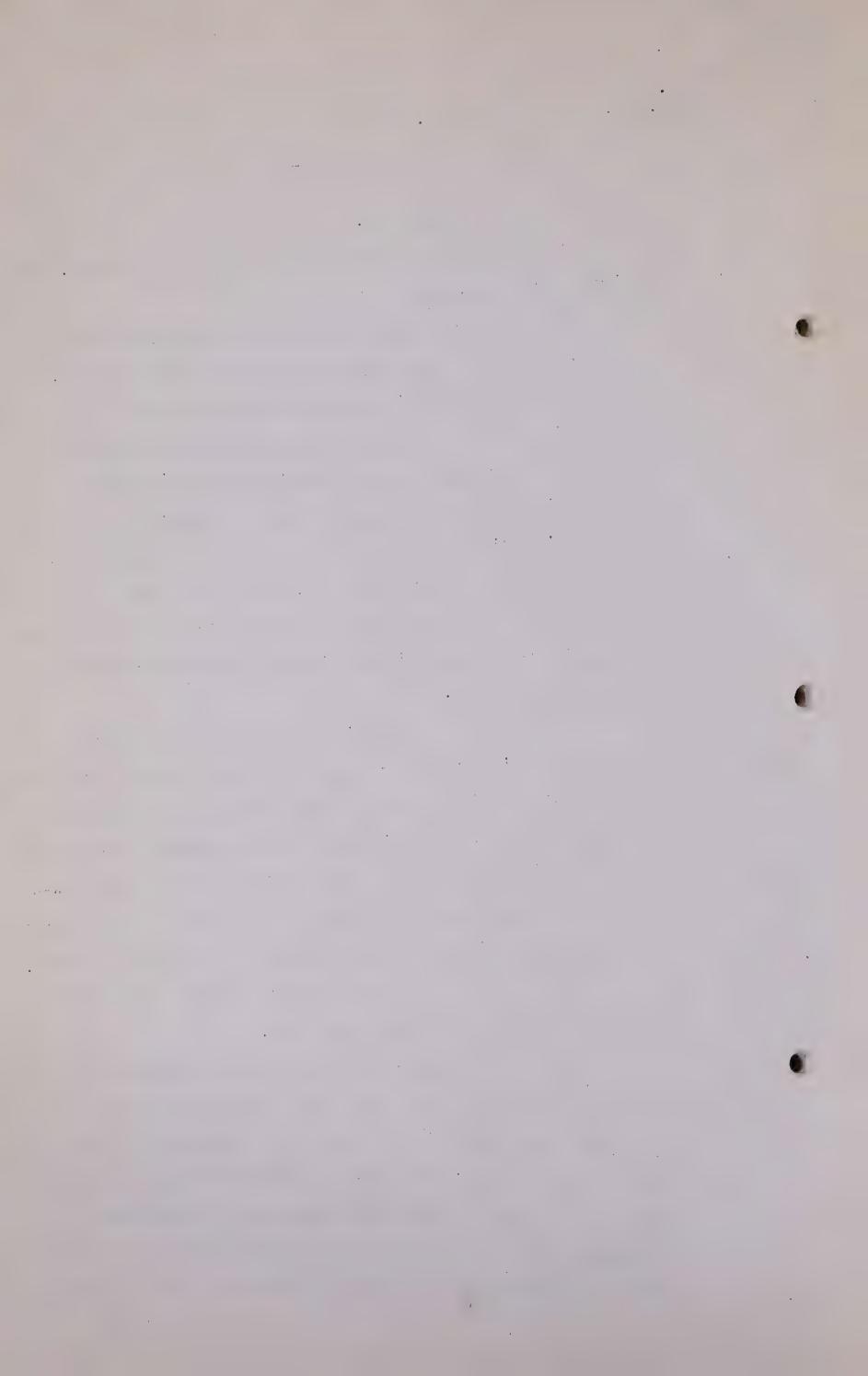
the method of rate base determination which appeared

most favorable to them. This would tend to make original

costs the minimum and reproduction costs the maximum."

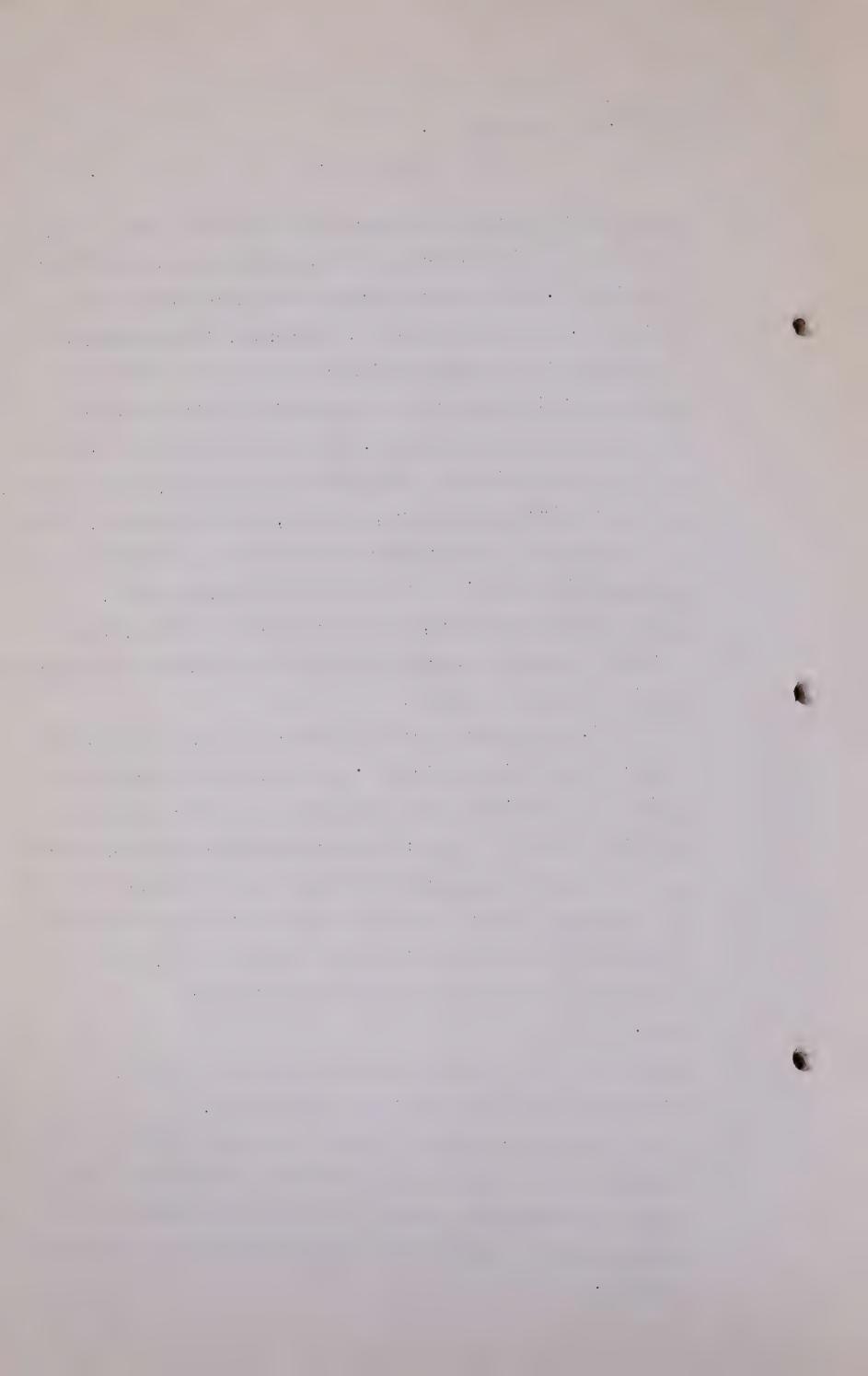
Now I do not reconcile that statement with what you have just told me.

I go on later on page 25, Mr. Chambers, and point out that if the initial rate base were high, the initial rate base in a period of high prices, then the reproduction costs might be used there. But if, on subsequent appraisal - that is if it was a continuing procedure - subsequent appraisals are to be made on the basis of the actual costs, then the determination of the initial rate base and the



reproduction cost basis would fix in your rate base a high valuation which is due merely to the timing of the initial appraisal. That represents in my view too large a concession. On the other hand, of course, if you propose to continue to use reproduction costs then at some times the prices will be lower and the appraisal will be lower and your returns will be lower. You do not then on that basis fix this high initial appraisal and value in your rate base. The two circumstances are, I think, quite different. Whether you continue on the reproduction cost basis or whether after the initial appraisal you go on to the actual cost.

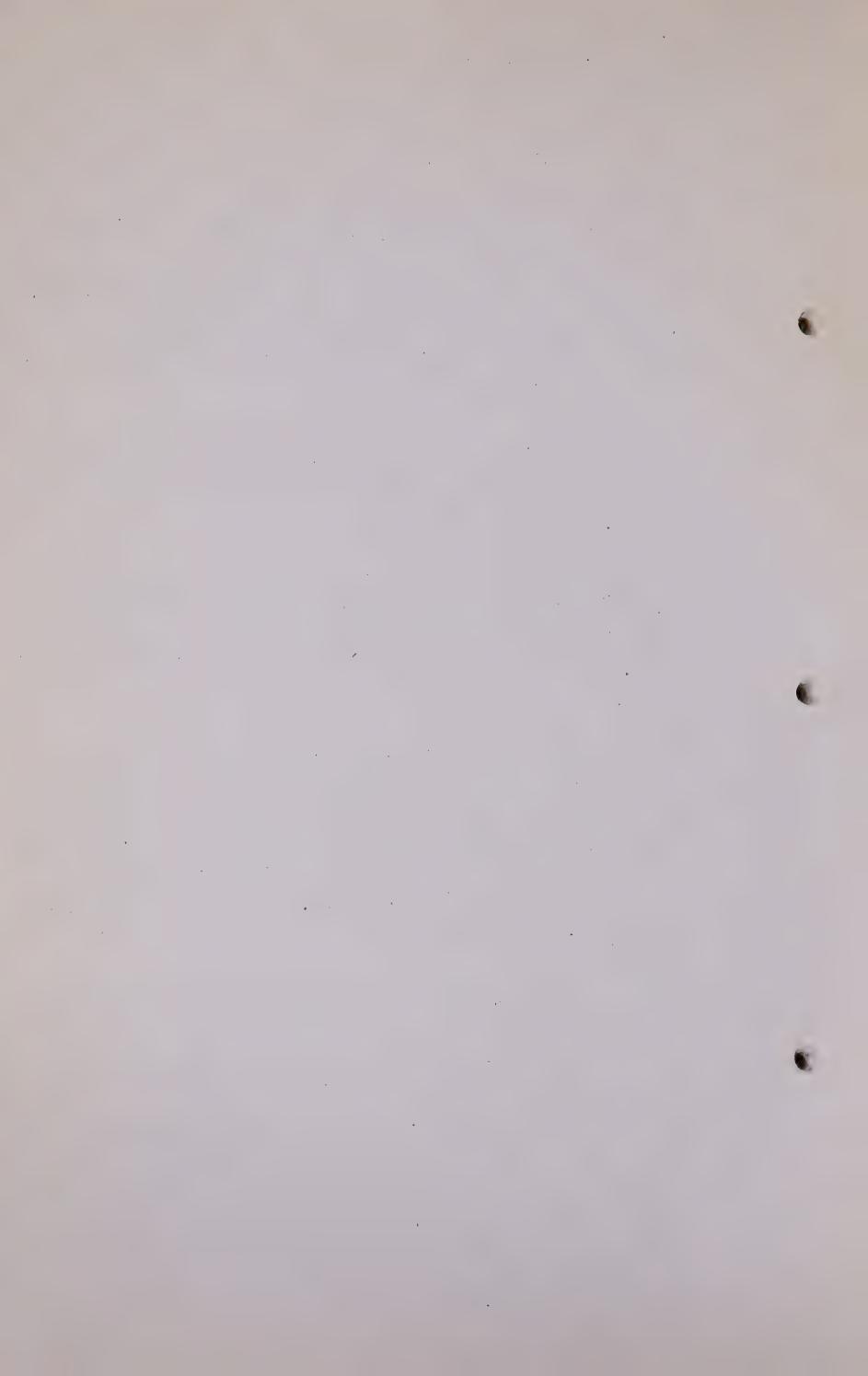
- Now Professor Stewart, would you agree with this, that the cost of an article, machine or plant, is largely or substantially made up of these things:
  - l. The current cost of labor and when I talk about labor I have visions in that of this, labor to gather or mine the constituent raw materials; labor to process and fabricate that material; labor to transport the raw material and the resulting processed article and the labor to market the finished article; and the labor to instal and assemble the article or series of articles in the plant. That would be one of the elements of cost would it not?
- A Yes.
- That would be one of the real substantial elements.
- A All construction costs involve labor costs.
- And in addition, included in that cost, are also the capital charges such as return and amortization of capital funds which are necessary, together with the labor that we have talked about to convert that natural resource to a finished article.
- A Yes.



In addition to those two elements of labor and cost of capital there is included the element of taxes. That would represent part of the cost would it not?

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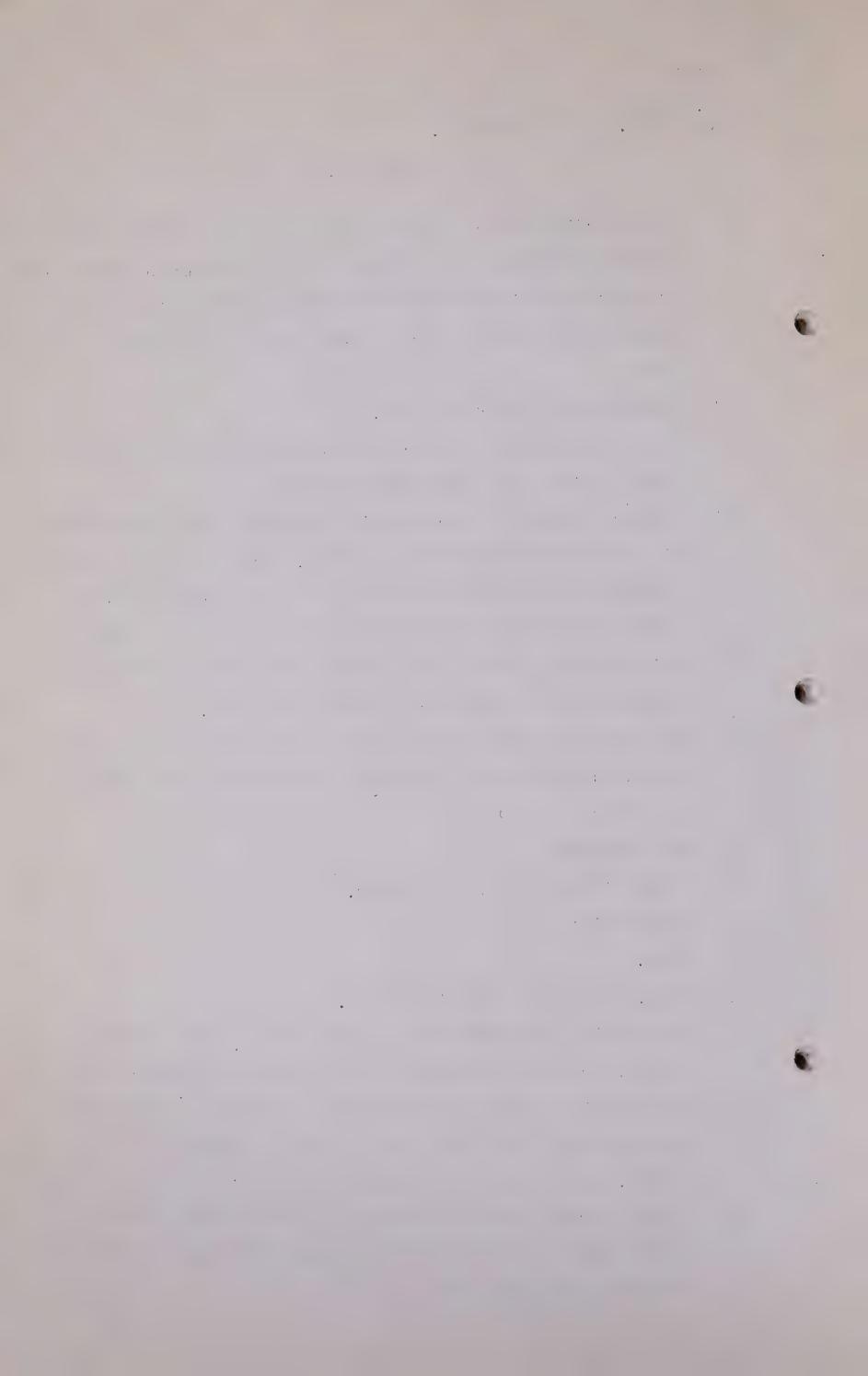
- A It is a question of how far taxes, the burden of taxes, rests upon the actual producer. Initially of course taxes are shown as an expense. To that extent they would appear in the costs.
- Now you will agree with me, I take it, that the trend of those component items, that is labor costs, capital costs and taxes, varies from time to time?
- A Yes.
- Would you agree with this, that the cost of a new or recently processed or completed article or plant would in general represent its fair value as at the date of its completion?
- A No.
- Why?
- Musing value in this case in terms of its earning capacity many things are constructed which do not, in fact, eventually provide a return of the capital invested in them. I am using value in that case as based upon earning capacity or in the earnings on capitalization sense. That is only one definition of value.
- First of all going back to articles and I will eliminate
  the word "Plant" at the moment. Articles do not as a general
  rule continue to be made or brought into being if they do
  not sell for their cost do they?
- A That I would agree with, yes. But in many cases they are produced and it is impossible to recover the cost.
- Well would you say that the cost new, of a new article, if it is in demand would fairly well represent the value?
- A We could so define value as being measured by cost of producing it, yes.



A. Stewart, Cross-Ex. by Mr. Chambers.

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- Well ordinarily am I not right in this that ordinarily people or companies or anybody else do not spend labor costs or pay taxes in the process of bringing that into being or embark their capital unless they expect to get their cost out?
- A Unless they expect to, yes.
- Q Yes, and assuming that can we not admit that the cost new would fairly well represent the value?
- A Under conditions of competition we expect that their will be a close relation between those, because if they diverge then that divergence will tend to set in motion forces which will bring them together again, to which in point of time they may diverge and in particular cases there is no assurance that people can recover the cost.
- Now would you agree with this that the average rates of wages in Canada have increased substantially from 1938 up to 1939?
- A Beg pardon?
- Q From 1913 to 1939, I am sorry.
- A From 1913?
- Q Yes.
- A Yes, wage rates have increased.
- I have the year books here if you want to check any of these, Professor Stewart, but it is my understanding from the reading of the year books that from 1915 to 1939 the average wage rates have never reverted back to the 1913 level. Would you like to check that?
- A I would accept that as being so. They did fall shortly after 1919 but I think it is correct that they did not revert to the 1913 level.



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- Now it is my understanding of the reading of the statistics in the Canada Year Book that even during the depression years from 1930 to 1935, the average wage rates for those years were 179.68% of the 1913 average. I am just asking you to assume that is so.
- A Yes. That probably is so, yes.
- And I am asking you to assume these figures rather than take you through the books. Then let us regard for the moment the period of 1935 to 1939 as 100, for wages. According to my computation of the figures, given in the Year Book that the wages for the period 1921 to 1925 were only 99.1% of this depression period we are talking about and that the 1926 to 1930 wages were 102.6 per cent of this depression period; and from 1936 to 1939 they were 101.7% of that same depression period; and that from the year 1936 to 1940 they were 103%. I am just making a comparison before and after. I am also asking you to assume this because I am coming up to another question, that following the close of the first Great War in 1918 the wage rate continued to increase. In 1918 they were 147% of what they had been back in 1913; in 1919 they were 173%; in 1920 they were 207% and that never since, even during these depression years, have they receded back to the 1918 level. Now assuming that that is the situation,
- A Yes.
- How do you, as an economist, explain or account for that situation?
- A Well, there are certainly two factors, probably three factors involved.

In the first place there is, of course, the increased efficiency of labor which would make it possible to pay the higher wage rate, now, without

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increasing the unit cost of the production of the commodity.

That trend has no doubt been going on.

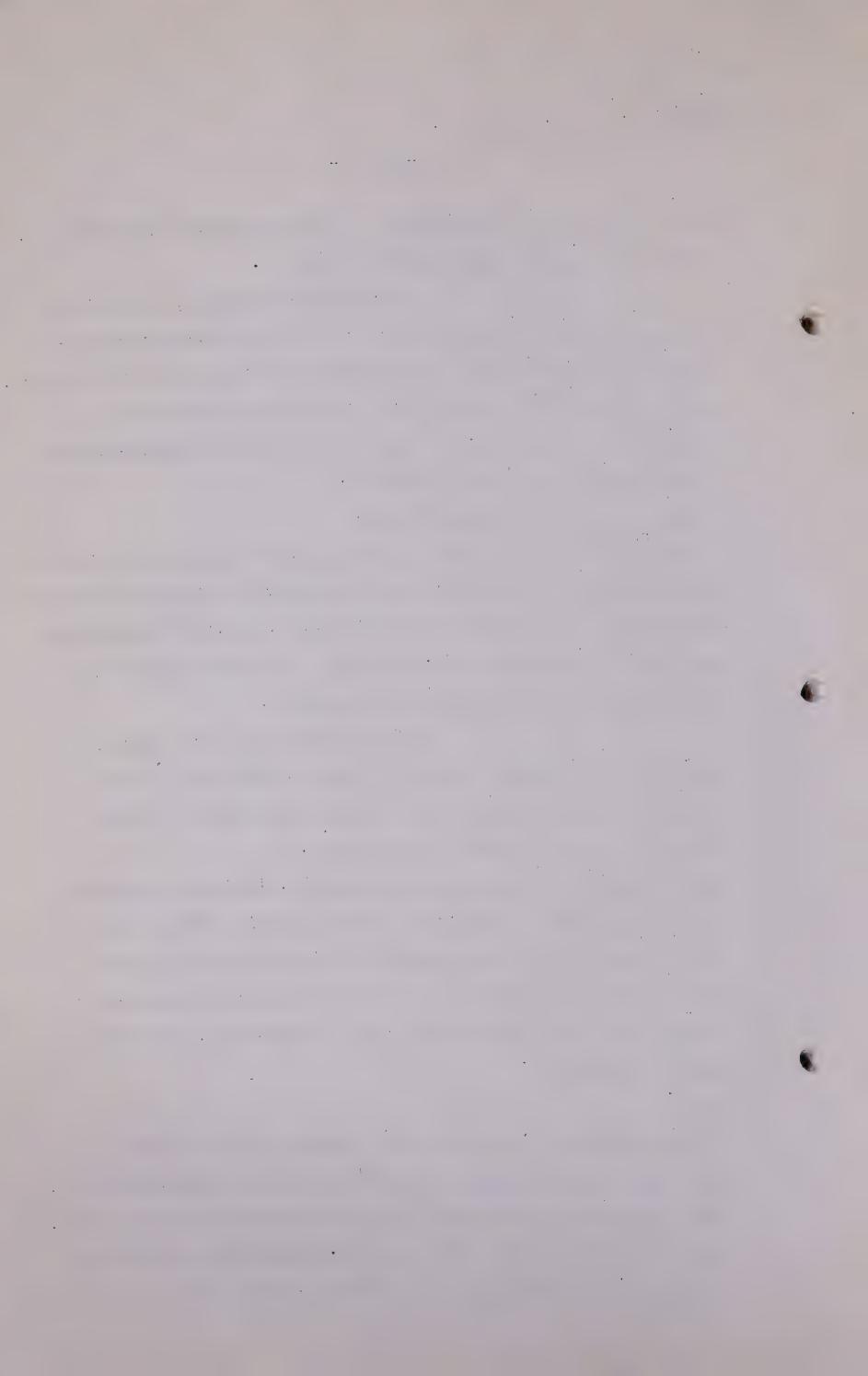
In the second place, we find that during war periods labor is in a position to secure concessions which they are not in under the conditions of peace.

And experience in the past has been that they have been effective in retaining at least part of those gains which labor makes during war periods.

- Would you say an extensive part?
- A I would not care to commit myself on that because it involves quantitative measurements of the effective factor but they do apparently retain part of their gains. Now that might mean merely a redistribution. The gains of labor might be at the expense of the earnings of capital.

And the third factor of course is that the price level might be higher. There might be an increase in the price level, so that all three of those factors apparently have to be known.

- Now referring to the statistics again, taking or regarding the period 1935 to 1939, that is the period 1935 to 1939 both inclusive as having an index figure of 100 as normal, with respect to the prices for what they call "producers' goods" and those are usually, as I understand, heavy type goods, equipment.
- A Yes.
- get these figures from the Canada Year Book, 1940, page 813; the comparable figures for the period 1926 to 1930 were 121.3% and from 1931 to 1935 they were 86.8% and 1936 to 1940 they were 102.3%. Now that would indicate, would it not, that



A. Stewart, Cross-Ex. by Mr. Chambers.

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certainly all the increases, the amounts of wages, rates of wages, paid to labor, was not overcome by an increase in the price figure, would it not?

- A I am not sure that that could be proved from those figures.
- No, I am not suggesting that. I do not know whether it has any relation to it.
- A I Would doubt if there were not some gains to labor merely as a result of the increase of wages in the last war.
- a You doubt there were not?
- A I would accept that there would be some gains retained by le bor which were not necessarily counter-balanced by an increase in price.
- Would you go this far, that a portion, some portion of the increased cost of producers' goods would be accounted for by increased wages?
- A Yes.
- Now, Professor Stewart, I take it you are aware of the general policy followed and measures taken in this country during the war to stabilize and control wages, salaries, rents and commodity prices, through the Wartime Prices and Trade Board, you know about that?
- A Yes.
- And that Board, as I understand it, as well as departments of the Government, also adopted measures to control the supply and the effective demand for labor and commodities, did they not?
- A Well I am not sure that came under the Wartime Prices and Trade Board, but there were regulations submitted through some . . . .
- a Through some Government agencies.

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A. Stewart, Cross-Ex. by Mr. Chambers.

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- A Yes.
- Now what, in a general way, would you, as an economist, say was the over-all effect up to the present time of those measures?
- A The control measures, Mr. Chambers?
- Yes.
- A That is a pretty broad question, the effect of what?
- Q Well we will deal with this, that prices are not now as high as they otherwise would likely have been, that there has been no corresponding increase.
- A Yes, I would agree with that.
- Now many of those controls are still being retained, for the time being anyway.
- A Yes.
- Now can you give me your opinion as to what the imposition of those controls during the war and being retained for a time, would have on our post-war enonomy, I know that is a pretty large question too.
- A Well I think that the price-stabilizing control which we have agreed has been effective in preventing a rise in prices which would otherwise have occurred, owing to the scarcity of building and consumer goods, that those controls should make it possible to avoid a collapse in prices later comparable to the collapse in prices following the last war.
- That is what I mean. I understand one of the purposes of their inception and certainly their continued control, is to control the general decline in prices of the nature that took place after the last war.
- A That was one of the purposes and I should think that the controls would be effective to some degree in that direction.

A. Stewart, Cross-Ex. by Mr. Chambers.

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- Yes. Now what, in your opinion, will be the result or the effect from the point of view of post-war taxation of, first of all, the increase of the national debt during the war and this post-war year anyway, and also, that is one factor and the other one, the extensive national plan for pensions and post-war rehabilitation of the men who have been in the armed forces, and the enactment of social security legislation; now what in your opinion will be the effect of those things on our post-war taxation.
- A Well I think Government budgets will have to be larger than they were preceding the war and in the long run those revenues have to be obtained from taxes.
- Now then there has been a considerable body of what we know as Labor Legislation enacted, both in the Provinces and in the Dominion, in the last few years, collective bargaining and things of that nature.
- A Yes.
- Now in your view would that legislation tend to effect wages, make them higher or lower, the wages?
- Well the effect will be different in different types of legislation. I would expect that in the case of collective bargaining legislation, which you mentioned, that that would assist labor in retaining its wartime gains.

on the other hand, in the case of say the Minimum Wage legislation, I understand its effectiveness, so far as the general level of wages is concerned
the minimum wage is usually so low as to affect only a few
cases.

with regard to Unemployment Insurance, the employer has to contribute part of that and the

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A. Stewart, Cross-Ex. by Mr. Chambers.

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immediate effect will be an increase in his costs.

There are, of course, compensating factors in some cases, the increase in efficiency of labor which may follow from some of those securities, those Legislative security devices.

Even in the case of Unemployment
Insurance, the general morale of workers may be increased
as a result of that. The same with the Family Allowances.
I would expect the general health and welfare would be increased, so it is rather difficult to trace the ultimate cost
in terms of the unit cost of the product, because we have a
combination of higher, many higher wage rates, but perhaps
an increased efficiency in some cases that will go with that.

- Have you been attracted, do you think that over the years the increase in wages and so on, those increases are fully recovered through efficiency?
- A No, I would not go so far as to say that. I think that legislation such as collective bargaining in the long run, has raised labor's share of the national income.
- Now is it not so that the unionizing of more classes of labor has been accelerated in the last few years?
- A Yes.
- And is it not so that the Unionsare becoming more powerful and are now in a better position to bargain than they used to be?
- A Yes.
- and this question of closed shop is an active one right now in some quarters?
- A Yes.
- Now probably I am repeating myself but I would like to get

A. Stewart, Cross-Ex. by Mr. Chambers.

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this clear again, would not those factors, that is the fact that more labor was being Unionized, collective bargaining and that there are more closed shops now than there used to be and the Unions being more powerful, will not those factors tend to maintain, if not increase, present-day labor costs?

- A I would be rather reluctant to commit myself on that but I think I would have to agree with you in part at least.
- If you want to qualify it I would be very glad to have you do so, you say "in part at least", I would like you to tell us what qualifications you have.
- As I said, the only possibility is its effect upon labor efficiency and unit costs and I would expect that some of it would not emerge as a cost to the producer for that reason, but I think I would go as far as to say that part of it will stick.
- And when you talk about part you are not talking about an infinitesimal part there I take it?
- A Well that is where I hesitate to commit myself. I would not like to give a quantitative expression.
- No, no, but it would be, I would like to know for the benefit of myself and the Chairman of the Board whether you think or not this part is something which is noticeable or very noticeable, you know what I mean.
- A Yes, I think significant.
- a "Significant", that is a good word.
- A Yes.
- Now is this not so, Professor Stewart, that we in this country and I mean the people generally, in common with those in the other Anglo-Saxon countries, have come to the point where there is a definite demand for and a

A. Stewart, Cross-Ex. by Mr. Chambers.

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recognition of the fact. that the standards of living and the mode of living of the lot, of the common or ordinary people, that an improvement in that regard is desirable, is that not a pretty well-held view of all the people in the country now?

- A I believe so, yes.
- And it is fairly well recognized that wages should be such as to enable the laborer to obtain and enjoy more of the benefits of life, more of the amenities of life, I believe that is the view now, is it not?
- A I believe all people of good-will feel that way.
- And which was not always recognized to the extent that it is now?
- A. No.
- And that they should enjoy more social security, the health insurance for instance I think you mentioned.
- A Yes.
- And that they should have more pensions and things of that kind, I mean that is a fairly general view now.
- A Yes.
- Well now then in the light of the discussion which we have just had, I am suggesting to you that that picture, together with the future problem of taxation, can lead one fairly to believe that we cannot reasonably look forward to a return of pre-war costs or any material recession in present-day costs, now what do you say as to that?

Andrew Stewart, Cross-Examined by Mr. Chambers.

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- A I would be more inclined to agree with the first part than the second part.
- Q Would you agree with the first part ?
- A I would be more inclined to agree with that way of putting it than the extreme opposite, because if I had to choose between the two I would I think agree that we may expect costs to remain above the level of the pre-war period.
- Q Well due to either one cr both of those causes I say would you agree that we cannot look forward to any appreciable recession of present day prices ?
- A Well it is a question of appreciable. I would expect some in the long run, some recession of current prices.
- Q You would not expect anything in the nature of the drop that happened after the other war?
- A I hope not. We hope that the measures taken during the war may well be effective in preventing that. We have a reasonable hope that they will be. So my position would be that I would not expect the price level to go back to pre-war levels but I would expect it to be lower than current that is your cost. I might add, of course, from the point of view of the general welfare of the economy, the most important thing is keeping people employed and so far as individual producers are concerned, stability of production at high level would make a material difference to their unit costs again. The output being increased, their overheads reduced.
- Q Would you think that when prices get off controls are lifted, that we might have a measure of inflation or increased costs?
- A That would depend upon the policy with regard to the elimination of control. At the moment controls are being gradually

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lifted as the supplies of the commodity increase, so that it is possible to sell them at something like the controlled price. If that policy is continued and price levels are only removed when the quantity has been built up to that point there is no necessary rise in prices to be expected.

- In other words you say if they take them off one by one or at the proper time, the result will be altogether different if removed all in one act?
- A Absolutely.
- Q On Page 24 of Exhibit 131 under the heading "Fairness to Investors" I find these words:

"On grounds of equity, therefore, there would appear to be a strong case for determining the initial rate base by reproduction cost; and some advocates of original cost have conceded that initial valuations should be made on the basis of reproduction cost, although subsequently the actual cost basis be adopted."

And then there is the other statement I have already referred to on Page 25. Do I take it, Professor Stewart, that you would favour the reproduction cost on this ground of equity? The economist should never get embroiled in the discussion of equity at all. But laying down the principles of reasonable expectation and alternative opportunity, if these are to be accepted principles, then I would say that if the action is initiated by the Legislature, that is it is not on the volition of the utility, and if the period is one of high prices and if reproduction cost is to be continued as the basis of determining the rate base, then I think that the initial determination could fairly be made on the basis of reproduction cost, but I would go on to argue that again in relation to those two

principles and if the movement comes or is initiated by the Legislature and prices are high but subsequently you are going on to the actual cost basis then I think the initial determination on the basis of reproduction cost is too large a concession to the investors. It depends upon conditions and I am trying to lay down the different conditions here and to indicate the conclusion which I would reach under the different conditions.

- Q THE CHAIRMAN: So that your conclusion depends upon whether you are to have a fixed or variable rate base?
- A Ultimately yes. We have had times, at least there have been times in the United States when the pressure for regulation has come from the utilities. Now that would change the picture, but in cases where the movement initiated from the Legislature then I would reach different conclusions and my conclusions would be qualified depending upon the basis upon which the rate base was determined subsequent to the initial determination.
- Q MR. CHAMBERS: Now you were at the University in 1938 were you?
- A Yes sir.
- And you remember that there was a Commission issued under the Public Inquiries Act to Mr. Justice McGillivray and to Mr. Lipsett, known as the McGillivray Commission?
- A I recollect that, yes.
- And I am asking you to assume that this is so and I will refer you to Chapter and Verse, but the Lieutenant Governor in Council issued a Commission or authority to those two gentlemen and I am quoting now, to make inquiry into the matters therein mentioned and to report thereon to the Governor in Council. Now among the matters that were referred to were

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these and again I quote;

The cost of gathering, \ handling and transporting in Alberta of crude petroleum and of refined petroleum products and without limiting the generality of the foregoing:

- (1) The ratescharged for the gathering, handling and transporting of crude petroleum by pipe line, or otherwise from Turner Valley to Calgary in the said Province, and what the fair and equitable rates for such gathering, handling and transporting should be.
  - (11) The adequacy and efficiency of present pipe line facilities.
  - (111) Whether existing pipe line facilities result in or tend toward an unwarranted control of the price of either crude petroleum or refined petroleum products."

And then I am asking you to assume that, I think in the spring of 1939 there was enacted the Pipe Line Regulation Act which in effect made the basis of the report of that Commission to be the subject matter of the first order of regulation under the Pipe Line Regulation Act.

Now in 1939 that Commission, in March 1939, issued an interim report, recommending that certain pipe lines be regulated and that a Statute be passed for that purpose, and the Commission enquired into and recommended the rates to be charged and that Statute was passed, the Pipe Line Regulation Act. And I want to read to you, to have your mind on it, one or two extracts from that report.

At the bottom of Page 18 of the report:

"Then again, it seems to us that the fact that the utilities are now for the first time being brought under the control of the regulatory body on the recommendation of your

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Commissioners, is to be taken into account".

I take it you agree that is an important fact?

A Yes.

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And then they go on, "It may be that in the future, a first-Q rate base being now determined, the regulatory body might well for the sake of simplicity and convenience dispense with engineering appraisals in further rate-making and adopt original cost methods treating the rate base now arrived at being original cost, that this would be justifiable only because all capital additions and improvements would then be made with full knowledge on the part of the investors that the rate of return accorded to them would be in the discretion of the Public Utilities Board", and then the report says, "It seems to us that the present position is quite different. Here a utility which had enjoyed freedom from interference from any outside body is for the first time subjected to regulatory In the case of future capital additions or improvements as stated, the investment is made when the investor's eyes are open to how the return upon his money will be measured. In the case in which a utility is being regulated for the first time, it is to be remembered that the capital already invested was invested prior to Government announcement of rate control."

Now would you agree with that statement?

- A Yes. I think that perhaps there are some additional considerations which might come into the choice of original or actual cost, but that would not change my agreement with that general statement.
- Now, probably this is the point that relates to what you have just mentioned, Professor Stewart. On page 20. I will read on from page 19.
  - There is something to be said for the view that a fair rate would be one that does not serve to destroy the property values which immediately prior to control reflected the reasonable expectation of investors."

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Would you agree with that proposition? You would, I take it?

- A Yos.
- We do not go that far because we think that doing the very best anyone can do for the investor, there can be no adjustment of the rate for public scrice in the public interest that generally speaking will entirely avoid disappointment to security holders."
- I mean, you would more or less agree with that statement too?

  A That comes into the administration, being very hard to employ the administrative tools with the degree of precision from their viewpoint.
- As to this it may be said, firstly that the Pipe Line Act provides for the regulation of rates, and secondly, that when investment is made in the business of 'Common Carriers' it is or should be known by those investing—that they are investing in property which is to be put to a public use and affected with a public interest, and which will in all likelihood be the subject of regulation in the public interest. This does not mean, however, that if this comes to pass the user of the utility is to get a better rate than one that is fair and to that end have a rate fixed upon the basis of value as it was any given number of years before."

I really only read that to you to give you the background of what is said next.

We may also point out that on the original cost basis if a utility is constructed during a high cost period the owner is entitled to collect a return upon original cost, notwithstanding a subsequent fall of the general price level. In other words, under the original cost doctrine which insures an investor a constant return upon his investment temporary high prices and high interest

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rates could be successfully projected into the future. On this theory all utility plant construction and additions would be made during peak price periods and the users would have to pay an annual charge for a service which could be reproduced for, perhaps, half the annual charge which they are called upon to endure. On the other hand if a utility were constructed during a low cost period upon the original cost theory the investor would be prevented from earning a return on more than his original investment even though owing to changed conditions the plant had trebled in value and even though no substitute plant, if presently erected, could perform the service at anything like the rates prescribed on the original cost basis.

And then they say this, they conclude;

We think that the conclusion is inescapable; that at least in the case of Common Carriers presently brought under the control of a regulatory body, a present rate must be rested upon a rate-base which includes the present value of the physical properties."

What would you say as to that?

- A The present value? Do you mean reproduction costs?
- reproduction cost in that.
- A Well I would not be prepared to go as far as that, Mr.Chambers, if you are going to go on to an actual cost basis afterwards.

  If you are going to continue on the reproduction cost basis, all right. I do not know whether that was implied in the Commission Report or not.
- Q I have not the page in front of me, but they certainly not only implied it but they recommended it?
- A They recommended it, the reproduction cost as a basis.
- Q No, they recommended whatever figure they should find would be

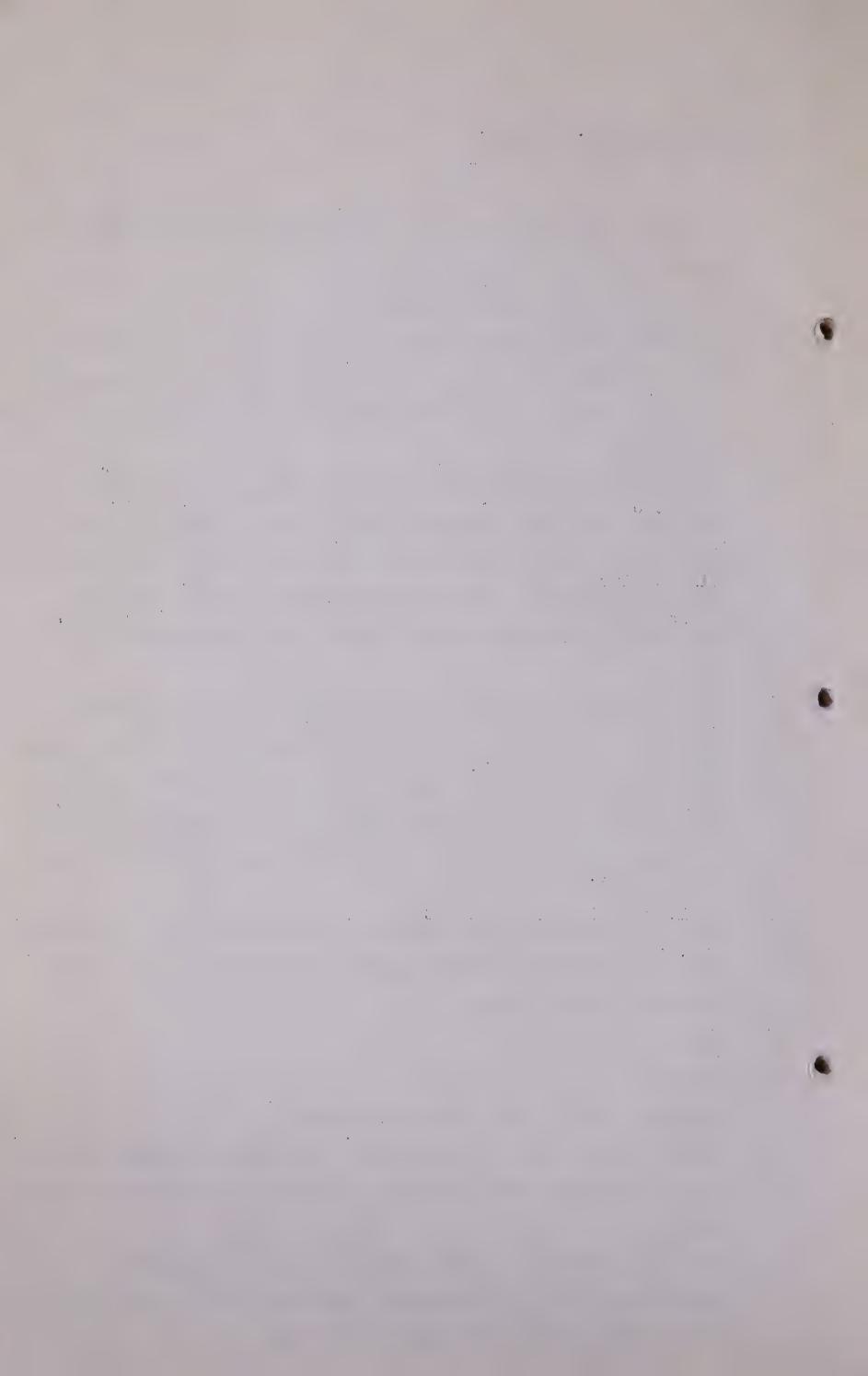
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regarded as the original prudent investment under regulation, you see?

- A And then go on to actual costs?
- Well from then on that point to the rate base that they found would be fixed, and any new moneys put into the business would be in at actual cost, because you knew that you were under regulation then?
- A Well I think in that event they were giving the investors more than they had any reasonable expectation of getting, if the prices were higher at that time in relation to the prices at the time of investment. If the prices then are high, then the reproduction cost was in fact higher than the original cost.
- Q Yes?
- A Well I think in that case you would take the high appraisal value in your rate base and give the investors a constant return on that high valuation, whereas the only reasonable expectation that they had was that in the periods of high prices they would have high returns and in periods of low prices they would have low returns.
- Q Well, assuming, Professor Stewart, the business was a successful one, one of the reasonable expectations would be, would it not, the right to sell it out?
- A Yes.
- Q In 1939?
- A Certainly, not at the time of investment.
- Q No, not at the time of investment. But I mean, we will say ....
- A One of the rights that they have is to sell the property is they want.
- And in a successful business wouldn't it be a reasonable expectation that they should get something based on the values at the date of sale, the costs at the date of sale?



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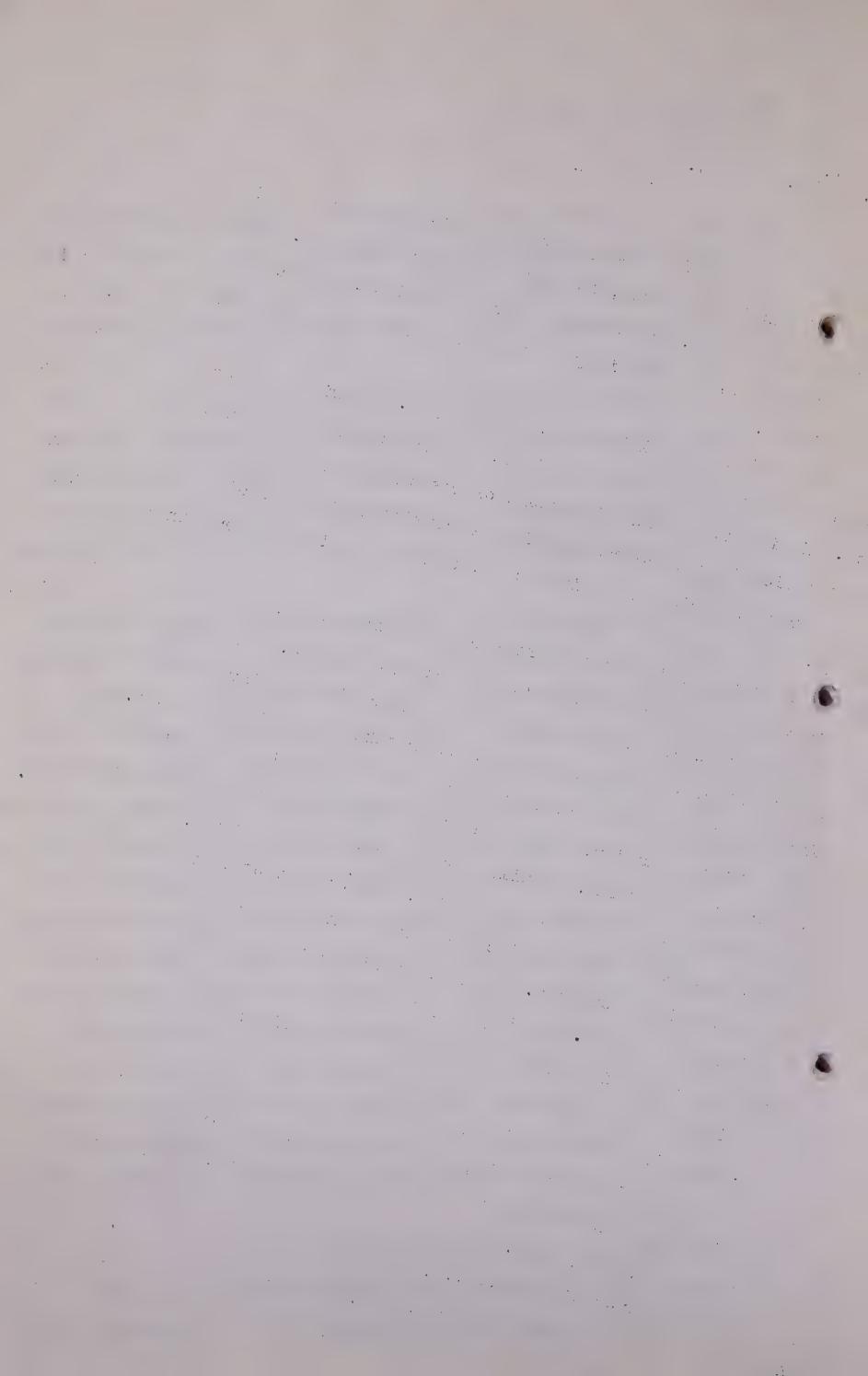
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- A Subject to the qualifications I mentioned before of the acceptance of a close relationship between cost and price.
- Q Yes?
- A In the absence of regulation one of the things that the utility can do is to sell its property and get the price at the time it sells.
- Now then, if regulation comes along and the initial rate base is based on the actual original cost, no matter when it was installed, is not the investor deprived of one of his reasonable expectations?
- A Of the right to soll you mean?
- Q Of the right to realize? He has the right to expect to realize on present day values?
- A Well, yes. The significance of that depends, of course, on the time at which the initial appraisal takes place. My argument there is that if legislation compels a utility to come under control at a time of high prices, then the utility should get the benefit of that?
- Q Yes?
- A But if you are then going to go on to the actual cost basis, then you are offering a permanent capital gain on the utility by doing that. Now, then, supposing the utility sold in the period of high prices in the absence of regulation and recovered that investment, which would be a large amount at that time, and re-invested it, they would find, of course, that tother securities were higher priced at that time and there would be no permanent capital gain from it. The transfer of the investment would not give them that capital gain.
- Q No, but Professor Stewart, does not that theory of yours assume that the person operating at the time, and it being one of high prices, that that is the peak that will ever be reached?

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- A No. I think the whole assumption on which the reproduction cost basis is itself based, is that prices are variable. That they go up and down, and that you have a varied rate base correspondingly, so that if you have high periods you also have low periods.
- Q Hore is what I would like to suggest to you. We will assume that the period was higher in 1939. We will say that that was so. It is just as fair to assume or reasonable to assume that the period in the future is going to consist of periods of two trends, periods of going up further and periods of dropping?
- A YGS.
- Now I am suggesting that by reason of the rate base, when you fix it on the reproduction cost new today, that is, the original prudent investment, that you are then depriving the investor of his right to gamble, we will say, or take the risk up or down.

  And then it would appear to me, and I am only asking you this to draw out/discussion, that reasoning of the McGillivray Commission of present day value, we will take the present day value, and that should be fixed for the future, and the investor will not get the advantage of any increase and he will get the advantage of preventing decreases. I mean, he will have a constant investment in the future. Don't you think that that is a fair answer or a fair solution to the reasonable expectations that these people had when they put the money in some years ago?
- No, I don't think so. I think that if you adopted that principle what you would do would be, you would induce legislatures to bring in regulation at times when prices were low. Now, I want to get away from that.
- Q Well Professor Stewart.....
- A Wouldn't/be a very significant consideration in the public interest with regard to the legislature if you adopted the prin-



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ciple that you are suggesting when they apply regulations.

- a Oh ycs?
- A And the time would be to do it when prices are low.
- Q Yos, but I at least give the legislature credit for trying to be fair without having any ulterior motive?
- A You give them more credit than I do, any legislature.
- I am suggesting this Professor Stewart, that, looking back say to 1913, that we have, I do not know what is the proper term, we have had and have an expanded economy and the general trend is up. There might be a drop for a short poriod of time. But to offect reproduction cost new as at this present date, and using the tas a frozen rate base for the future, you are not really giving the investor any more than he is entitled to, or entitled to expect because the chances are, because it is based on what has already taken place, that the price might go up on the general curve rather than down?
- Well, there is a problem of distinguishing between a trend in of prices and the shorter periods. /variation. I think I said under examination with regard to future prices that I would not expect them to be as high as they are at the present time, that is, the long line trend. That is, I look forward to variations in prices from this level, but that this is a period of relatively high prices, and anything like an average price in the future would be lower than the price at the present time.
- Q Have you taken into consideration the increased national debt, the wage situation and so on? You think the prices will recede?
- A I think we will have variations in prices, and that prices of labour and of some materials, and certainly the costs of construction, will not remain at the present high level. They will

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vary downwards. I think this is a relatively high period. In regard to that, Mr. Ghambers, in relation to reasonable expectations at the time of investment, which is the basis of the argument in the statement here, I think there is a permanent gain to the utility if reproduction costs were introduced at the present time, and, in relation to the possibility of sale, I think that my answer would be that if you sold at the present time you would have to buy other investments at a high price and your returns in the long run would be lower.

THE CHAIRMAN: I think we will adjourn now,

Mr. Chambers.

MR. CHAMBERS: All right, Sir.

(The Hearing was then adjourned to 9.30 A.M., December 4th, 1945).

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